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Defective Land Title Insurance in Sri Lanka: A Scheme to Guarantee the Mortgaging of Land

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Title insurance originated in the United States as a market response to resolve the uncertainties that land owners and bankers encountered due to land title defects. There are two types of title insurance policies—mortgagees' policy and owners' policy. The first type of policy indemnifies banks against loss or damage arising out of existing title defects of land belonging to the mortgagor. The second (Owners Policy) guarantees the title of owners by indemnifying them for loss or damage arising out of defects prior to acquisition of the land.

This paper discusses a different model of title insurance to the above conventional system which was established in Sri Lanka to obtain greater security in their ownership of land for those owners who did not have marketable title to obtain bank loans. The paper explains the origin and nature of title insurance, analysis of land title in Sri Lanka prior to introduction of title insurance, reasons for unacceptability of private lands for bank loans, laws relating to private property rights in Sri Lanka, the introduction of the innovative methods to make lands credit worthy, the unique documents and methods adopted to accept the risks to issue policies and the resulting changes and ancillary advantages experienced by owners and lenders.

The process was not designed to give land title to the holders of parcels of land, but was created to facilitate the extension of credit facilities to owners. The underline principle was to make the lands marketable by issuing a policy to cover defects in title. Thus it was referred to as Defective Title Insurance. Marketability of title is an ethereal sort of thing enshrouded with prejudices. It depends on customs, habits and practices in a society and varies from one community to another; it does not have a universal meaning. When disputes are minimal, properties are marketable in a society and the defect of 'not having formal title' could be insured as the risk for the insurer is negligible

Property rights in Sri Lanka during waning years of the 1960's

Property rights in Sri Lanka have been embedded in a complex web of interactions. Acquisitions usage rules and enforcement methods operated within a Deed Registration system which had existed since the year 1863 when the first ordinance on the subject was passed. There were relatively efficient deeds registries in every district of the country.. Owners of land mainly in the

¹ I was privileged to work with Dr A.R.B.Amerasighe at the Insurance Corporation of Ceylon presently Sri Lanka in 1972, my first job as a young Attorney out of Law School. I had the opportunity to study the informal rural land tenure system. I traveled to all the land registries of the country in remote areas to do title searches, to prepare abstracts and Title Reports for the rural lands presented to the Corporation to be insured. Once the business of insurance was privatized I was privileged to be a legal consultant to the private sector companies to establish title insurance which has progressed to be a lucrative business. I am available to answer questions: "K.S. Gunasekera" <sriyangani@googlemail.com>

towns had focused on an institutional environment that provided people with secure divisible property rights registered under the deeds registration system. Therefore, these lands were marketable and credit worthy, backed up by archives for well over 100 years. Upon the death of owners Testamentary Cases [Sri Lanka requires court procedure] were duly filed in court and the new owners by inheritance were correctly documented and the documents archived.

In addition to the above there were lands owned by people through government grants and vesting orders, and lands that were owned by virtue of Partition Decrees [a court procedure]. Typically the holders of these lands had adequate documents and had marketable title or good title. Such titles were referred to as First Class Title, and were credit worthy, acceptable by banks for extending credit facilities.

However a majority of the owners of land held and possessed their lands according to informal systems, such as ownership with a single deed without proof of predecessors in title, possession without testamentary proof of heirs which gave rise to shares being owned in common., absence of documental evidence to support servitudes and other ancillary rights, for example private road accesses. The documents often used descriptions of land according to what they produced: for example Coconut land as sufficient to plant 60 Coconut trees was said to be one Acre. Paddy cultivation measured in land sufficient to cultivate 1 Amunam was considered to be 2 1/2 Acres. One Kuruni of edible seeds were said to be 10 perches. The measurement system differed in the areas where different ethnic groups lived. Even today people express their own measurement system in their own language: 24 Lachams to mean 1 Acre; 6 Marakkals to mean 1 Acre. These are a few references to a vast system of measurements which people use in daily practice.

There were further problems, such as forgeries of documents, clerical errors in registration, conditional deeds, which included conditions to restrict ownership rights such as life interest of parents brothers and sisters, restriction on sale and mortgage. [It should be noted that the previous laws restricting mortgage and sale of properties are presently repealed].

In addition property rights are governed by plethora of legal systems such as the Roman Dutch Law, Customary Laws such as Kandyan Law, Thesawalamai Law, Muslim Law and Statute Law based on Indian and English Law introduced during English colonial rule. The customary laws did not grant men and women equal rights to property rights; in other words, unlike purchasing a watch, to purchase, sell and mortgage land it is necessary to know whether a person is a Muslim Tamil or a Sinhalese [Kandyan or Low Country], a man or a woman.

The majority of lands were rejected by banks as land rights were insecure.

The principal sources of credit in the 1960s in Sri Lanka were state banks and other credit providing institutions. The statutory instruments regulating the affairs of these institutions permitted the granting of loans provided that their Boards [Chairman and directors] were satisfied that any property offered as security was credit worthy. Whether the Boards were 'satisfied' depended essentially on the advice of their legal advisors. The legal advisors to the Boards were highly esteemed senior professionals, and they quite often recommended against the granting of loans on the basis of the security offered, as they were unmarketable due to the facts

given above. Very often court action was the only available solution to obtain clarity of ownership. The courts system which was already bursting at the seams while trying to cope with many disputes involving land did not serve the purpose as it involved delays up to about two years. The lands in the country were either good or bad for guaranteeing loans, depending on the acceptability of title by banks.

The effort to bring a solution to the rejected lands of Sri Lanka

In the 1960s it was the considered opinion of the advisers of the government of Sri Lanka that a way forward to social and economic growth and the achievement of development goals was the extension of the basis of credit to assist home builders and entrepreneurs, especially at lower and middle income levels. But there was the problem of defective titles and rejected titles of proffered security standing in the way.

Questions were raised and discussed. Was it possible to wait until Cadastral plans were drawn for nearly 8.5 Million parcels of land? Will title registration establishing divided parcels for owners immediately increase economic growth? Was Sri Lanka ready for such a project for the massive title registration and cadastre, ignoring the norms of the society? At the same time consideration had to be given to the deed registration system which worked very well in Sri Lanka with efficiency at this time.

The model answer for the above was to introduce the Torrens title registration system and as well as introduce the use of cadastral maps as the means for defining properties on which to base title registration. However, such an ambitious project involving among other things a considerable length of time and detailed cadastral surveys was not affordable at a national level given the financial constraints of the Sri Lankan economic milieu. Moreover, in the process of compelling people to obtain perfect titles, local culture was ignored: Hundreds of thousands of families lived in peace sharing their undivided inheritances. (Indeed, they still do.) To drive them by legal compulsion to have precisely identified parcels of land would cause needless rifts and social unrest in the cultural climate of Sri Lanka. The courts system could not cope with settling disputes to arrive at precise definitions of individual owners and precise parcel boundaries, to facilitate registration of ownership.

The need for a solution came at a propitious time not only because it was then an ancillary measure to government policy to promote the extension of the basis of credit but also because the carrying out of official intentions came to be placed in the hands of two extraordinary intellectuals – Mr. G.V.S. de Silva a renowned civil servant and a well known economist and Dr. A.R.B. Amerasinghe who later became an eminent member of the Supreme Court. They were respectively the Chairman and Board Secretary-Chief Legal Officer later General Manager of the Insurance Corporation of Ceylon [presently Sri Lanka]. They considered the idea to insure land titles through the creation of title insurance policies to cover the formal title defects which the banks pointed out as causes for rejection of credit applications. Dr Amerasinghe proceeded to the United States where he met with and discussed the subject of Title Insurance with many insurance professionals. A study report was then submitted which comprehensively analyzed the causes of title defects in both the United States and in Sri Lanka and proposed remedies. The document was subsequently printed and published as a book. It was Dr.

Amerasinghe's vision and intellectual skill that gave a quick remedy to land owners to access commercial credit, which was truly a national service to Sri Lanka..

A unique title insurance scheme came into operation, called "Defective Title Insurance" is still not sufficiently known and appreciated around the globe. A policy was designed to cover known defects that the banks listed as the grounds for rejecting title to land presented as potential guarantee for loans. On 16th Feb 1970 the state owned Insurance Corporation of Ceylon [presently Sri Lanka] issued the first three Policies. To date about two hundred thousand policies have been issued for those unmarketable lands which were idling classified as rejected for guaranteeing bank loans.

The project was met with hostile reaction from some banks, but with dialogue and practical testing of the new insurance idea, such reactions were soon short lived. The banks later became the advocates of defective title insurance to any one who had defective land title and who could qualify for a policy.

Solving the problem: formidable task of accepting the risk by the Insurance Corporation.

Full land rights included in a document called a deed or certificate of title under title registration includes all the rights that accrue to an owner picturesquely described by some as a 'bundle of sticks'. The sticks refer to the rights derived from title registration, which include possession, right to alienate, right to sell, lease, mortgage, right to use and enjoy trees and plantations on the land, the right to construct (under appropriate circumstances); in other words such rights to the land without restrictions or interference from others. The right to mortgage (which is basically the right to contract with a lender to transfer title to the lender should the borrower not pay back a loan) is of utmost importance for economic liberalization which allows a land to be used especially for grass root entrepreneurs. This ability to mortgage is what we wanted to achieve, rather than give title to land. Title insurance came as a miraculous solution to assure the right to mortgage land, and was a major step in improving land usage in Sri Lanka.

Proving title to land from available documents

Providing sufficient evidence of title to land for mortgaging purposes from the existing documents was the next step. Land owners possess various documents such as old deeds, manuscripts from their ancestors, private archives belonging to ancestors which are extremely authentic documents. The private plans drawn by licensed surveyors from the early 19th century had an abundance of information regarding ownership endorsed on plans. This would even include subdivisions, devolution on death and rights such as road ways liens and servitudes. Such evidences in the local context were as good as certificates of title. The ownership of lands could be traced back for hundreds of years, from plans which would indicate the larger parcels from which the lands were divided. Sometimes towns were named after the owners, as owning land was prestigious and the land rights were maintained in a manner that the public was aware that the lands belonged to the descendants of certain families in the villages. The rights of water, water wells, the access roads and cultivation rights that were shared were well defined and these rights did not interfere with the marketability of such lands in the minds of the local people. The

study of the local system for defining rights to land and documents was not that difficult due to the administration that was set up for title Insurance .

The task was to obtain the maximum evidence to prove the de facto claims. As investigations proceeded proof and numerous methods were available to endorse ownership which were kept by local residents. Fortunately Local Authorities of the areas had also recognized the de facto land titles for collection of taxes. Therefore in some cases the land parcels had assessment numbers with identified owners. Collection of facts to establish ownership was further supported by affidavits from village elders and officials of villages who knew the owners. As mentioned earlier especially when land ownership devolves on succession after the death of owners, the heirs remain unregistered co-owners. After possessing for about 10 to 12 years land was marketable in many areas irrespective of the non performance of legal procedures. Extra legal methods were sufficient to prove heirs beyond doubt such as Death Certificates, death notices, news paper notices. These documents are supported by affidavits from people who hold government office in villages. The general public is now familiar with the set of documents that are necessary to insure mortgage-able land title. Today title insurance is taken for granted as the cure for all lands that had not been accepted as collateral by banks.

The mortgage-able title had to be notarized to create document of ownership, which would be a source of title in lieu of title certificate. The conveyancers in urban and rural areas knew all branches of the law and practices, pertaining to the duties and principals of ownership within a society.. These notaries had executed, attested and created various documents which are not easily found within formal title registration methods. . The following are some of the documents which created rights, vested ownership and rectified errors. These notarized documents became sources of title and were inexpensive within the reach of people with a very low conveyancing cost.

Deed of Declaration

Deeds known as deeds of Declaration recite the rights of ownership, proved by way of possessory documents. A Deed of Declaration could be registered under the document of an ancestor who owned the land if available in the land registry or it could be registered as a source of title. The deed also included the boundaries and the extents of the land held according to the old plans with description of metes and bounds with a new survey plan according to recognized system of measurement, and not according to the methods used in the rural areas

Conditional Transfers

There were private lenders who gave money to land owners. This was a practice in villages as banks were unapproachable. Documents executed in lieu of mortgage bonds confirmed the ownership to the lender if the debts were not repaid with interest, or reconfirmed the reversion of the land to the owner if the debts were paid. These documents were always registered for the lenders benefit and they were useful to prove ownership to land in the absence of formal title deeds for the purpose of title insurance.

Deeds of Renunciation

These are deeds that renounce rights to land for better confirmation of ownership. For example, a servitude right may be renounced, as can rights of way over lands of neighbours, the rights to water, life interests in land and other interests of owners.

Deeds of Rectification

These are deeds which correct registry errors and errors of notaries.

Partition Deeds

Landowners declare the ownership of the divided portions on a deed. Signature of all co-owners on the deed confirms ownership. Similarly survey plans were also used in the early days to certify divided parcels. Thereafter the deed of partition is held as the source of title for ownership. The plans were a source of title but title was not registered as in deeds of Partition which were registered instruments. The defect of not being registered had to be rectified through deeds of Declaration as mentioned earlier.

Deeds of Exchange

Land was transferred between family members in exchange for another piece of land. The documents describing such exchanges do not require stamp duty if the properties are of the same value.

Example to illustrate the usage of documents above----

Once I had the experience of issuing a policy for a land which had only a single survey plan about 40 years old. The owner did not have any other documents but had possessory rights of the land and the right of way to the parcel. The plan however recorded the names of the predecessors in title. The surveyors in the old days certified names of the owners and even obtained signatures on plans, to identify the parcels of land and the interests in those parcels. To issue the policy a new plan had to be drawn and the surveyor had to authenticate that the land was the same land that was depicted on the old plan. This system of identification was unique, as the surveyors were very familiar with the lands in areas they practiced.

A Deed of Declaration was executed by the owner reciting the ownership and devolution as given in the old plans supported by the documents. The land was described according to the new plan and supported by the old plan with proper boundaries and extents according to the recognized measurement systems.

Access rights through the neighbours land had to be established to insure the title to the land, the confirmation of the right was obtained by means of a Deed of Renunciation where the rights to claim the area covered by the road was renounced in favor of the owner. After registering the two deeds, the Deed of Declaration and the Deed of Renunciation, the title became insurable.

Insurance policy and the premium

Title insurance unlike other forms of insurance is a once – off payment made on purchase of the policy. Policy is issued in the name of the bank in the case of a mortgagees’ policy and in the name of the owner if it is an owners’ policy.

The value of the premium is calculated on the value of the policy required. Generally the bank through their panel of appraisers obtained a valuation report of the land. This report was obtained after the response from the insurer that the land and the defects could be insured. Earlier this was done through a document called a Binder which guaranteed the issue of the policy. Due to delays with this process, policies are presently directly issued to the banks.

For title examination of lands a panel of lawyers from each district of the country was appointed. The reports and abstracts forwarded by panel lawyers were re examined by the lawyers of the corporation to assess the risk. All the legal fees were paid for abstracts and reports by the insurance corporation. A minimal fee was charged from the insurer as a processing fee which was negligible compared to legal fees which were unaffordable. Reinsurance was considered but has not been viewed as viable and I think in time reinsures and actuaries will render an even better service.

Owners’ policies benefited developers

The property developers obtained Owners’ Policies for lands with defective title. The purchasers who required a loan to purchase a parcel divided from a larger one which had been insured, referred their bankers to the owners’ policy for that larger parcel, often referred to as a Master File. The process guaranteed insurance to all qualified parcels. This was a great asset to property developers who developed neglected properties which were abandoned due to lack of proper title to land.

Insurance business in Sri Lanka

The business of insurance was nationalized completely in 1964 and the Insurance Corporation established. The sector was reformed in 1987 with laws coming back into effect allowing private companies to operate. Title insurance commenced as a department within the Insurance Corporation which handled various types of insurance. Once the government monopoly was removed the private companies continued in the same manner.

The task of insuring defective title was difficult for various reasons. For one thing, there was a total absence of literature on the subject. Even in USA where private title insurance companies have existed for almost a century the subject is virtually neglected. However the Sri Lankan officers made an on-the-spot study of the American system and submitted a paper on the subject. The subject was widely discussed. President of the Law Society prepared a note on the subject and contributed his ideas. The Governor of the Central Bank and some General Managers of Banks and Actuaries also wrote on the subject. Their views were important. A solution had to be found for our national problem of formally defective land titles, and such a solution had to be set in the context of our own legal economic and social system. The main idea behind the insurance scheme was that land should be readily available for maximum use. The success of the venture depended on the assistance of the Banks and the legal profession. It also depended on the

knowledge that the public had on the subject. I would like to mention that the private sector may not have been bold enough to take a major step of this magnitude, which underlined the importance of the political will to make government funds available to start the business through a government corporation.

The studies prepared at the time were very effective. The General Manager and the Chairman of the Insurance Corporation at the time had made a very good study of the ownership rights of the people in villages. They found that the risk of default was minimal because of the relationship the people had with land, their methods of marketing and the local resolution of disputes in practice were not entirely dependent on title registration and technical methods which were prescribed by the law.

Advantages

The system adopted by Sri Lanka to insure defective title for mortgage purposes was devoid of court procedure and after the initial establishment of the Insurance Corporation became independent of government interference. Although undoubtedly title registration is the best method to make land credit worthy it is costly and difficult to continue unless the administration is secure and works within the rule of law. The Conveyancing costs and inept administrations in land registries could cause land owners to revert back to their own systems. In contrast title insurance has produced the best legal advice from the lawyers of the insurance corporation and has the attractive advantage of obtaining loans from banks. The system accommodated local owners the freedom to use their knowledge of the lands and to use their own documents of ownership to establish ownership. The method proved quite successful.

Defective title insurance guarantees only the marketability of the property. If a mortgagee's policy is issued to a bank, and if the loan is not paid back, the insurance company does not pay the bank the balance on the defaulted loan. The bank has to follow the banking procedure, has to sell the property to recover the balance owed. If the bank fails to recover because the land turns out not to be marketable, then insurance company pays the bank the amount owed. The insurer then has the right to sue the alleged owner of the land to recover the funds paid to the bank and other costs.

The purpose of defective title insurance is to guarantee the titles that are informal –such titles to land do not promote entrepreneurship. All those who came to insure lands were ready with the other factors to make good use of the loaned funds, such as knowledge to invest. The banks' regulations and procedures tend to be static-- they do not change easily. Banks appreciated someone tackling the problem of unmarketable land titles, which the insurance company has done.

Title insurance principles did not remain static. They developed and changed to meet new requirements. People could come directly to the corporation without legal representation to insure their lands. It is now over 30 years and the claims and disputes are negligible. One result is that many banks reduced the lengthy searches, lands with rural title which were documented and registered as above were accepted as credit worthy. The very concept of marketability changed to accommodate more of rural titles rectified in the manners described above.