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Closing Protection Letters Frequently Asked Questions

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What is the purpose of a Closing Protection Letter?

In a Closing Protection Letter, your underwriter agrees to reimburse the addressee if your title agency is guilty of fraud or dishonesty in handling the closing money or documents, which courts have said covers more than just theft of the loan money, or if you fail to follow certain written closing instructions.

Lenders entrust loan money to your company when your underwriter puts its financial strength behind you by agreeing to pay the lender if the money is stolen or you fail to follow the closing instructions.

How does the Closing Protection Letter help me?

Title insurers issue Closing Protection Letters to make it possible for you to serve as a loan closer.

The Dodd-Frank Act and CFPB rules now say that a lender may be directly liable for the acts of a closer it hires when the closer violates the law. See 12 U.S.C. §§ 5514-15. "Service provider" is defined at 12 U.S.C. § 5481(26). See also CFPB Bulletin 2012-03 regarding Service Providers. This means it would be possible for a seller, borrower or other person to sue the lender directly when a title agent closer steals closing money.

The Dodd-Frank Act requires that lenders conduct "thorough due diligence to verify that the service provider understands and is capable of complying with Federal consumer financial law." See CFPB Bulletin 2012-03, page 2. The only vetting process used by many lenders in approving a title company as their closing agents is to get a Closing Protection Letter from your underwriter. Most lenders make the issuance of a Closing Protection Letter the main building block of their vetting of your company for their approved-closer lists.

Now more than ever, almost no lender will hire a title agent as its closing agent without the issuance of a Closing Protection Letter by its underwriter.

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Why do title insurers issue Closing Protection Letters?

The Closing Protection Letter started as a very informal request by certain lenders in the 1970's, when those lenders were beginning to lend across the nation and title insurers were just building national agent networks.

Title insurance companies were willing to issue Closing Protection Letters to assist their agents in getting into the loan closing business by encouraging out-of-state lenders to hire them to close loans made to local residents.

The first Closing Protection Letters were issued as letters, not insurance policies or other more formal agreements, because the requests were informal and title insurers have no legal authority to issue surety bonds or other insurance for title agents.

Why has the Closing Protection Letter become an issue now?

The practices about issuance of Closing Protection Letters have changed very little over the years.

What has changed is that owners and employees of title agencies have stolen several hundred million dollars of money entrusted to them, with a steady increase in theft from the 1990's to the present.

Title insurers did not plan on paying out millions of dollars a year to provide free coverage against title agent closing acts, when they do not share in any of that closing revenue.

Also, lenders—especially the FDIC—have pushed very hard in the courts to stretch the coverage of the Closing Protection Letter so that it covers more than what the title industry intended.

For example, the FDIC has succeeded in Michigan and other states in making the insurer pay the FDIC the full amount of the loan, when the loan amount was pumped up by a fraudulent appraisal of the real estate. In the Michigan example, the title insurer paid the holder of the loan over $2 million, which was the real value of the property, under its policy claim. Then the FDIC made a separate claim under the Closing Protection Letter, which the court said it still "owned" after it

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assigned the loan. The court permitted the FDIC to collect the balance of the $5 million loan from the title insurer. *JPMorgan Chase Bank, N.A. v. First American Title Ins. Co*., 750 F.3d 573 (6th Cir. (Mich.) 2014). See also, *Bank of America, N.A. v. First American Title Ins. Co*., 2014 WL 1271227 (Mich.App. 2014) (unpublished), app. granted 497 Mich. 896, 2014 WL 1271227 (Nov. 19, 2014) and *Federal Deposit Ins. Corp. v. First American Title Ins. Co*., 2015 WL 1906139, ___ Fed.Appx. ___ (11th Cir. (Fla.) 2015) (unpublished).

Do title insurers pay claims on Closing Protection Letters when the title agent has not stolen the closing money?

Yes. In *Federal Deposit Ins. Corp. v. First American Title Ins. Co*., 2015 WL 1906139, ___ Fed.Appx. ___ (11th Cir. (Fla.) 2015) (unpublished), the court said the "dishonesty" coverage of the Closing Protection Letter was invoked solely because the closer received the borrower's down payment from a third party. The court made the title insurer pay the entire loan amount to the FDIC, even though that loan amount was far more than the property was ever worth. It relied almost entirely on the Michigan decision of *JPMorgan Chase Bank, N.A. v. First American Title Ins. Co*., 750 F.3d 573 (6th Cir. (Mich.) 2014). The court said this about the "dishonesty" of the title agent, Property Transfer:

> Property Transfer’s "failure" and "dishonesty" undoubtedly bore at least a "minimal causal relationship" to Old Bank's "actual loss." ... As a result of Property Transfer's "failure" to follow Old Bank's closing instructions, that is, as a result of Property Transfer's "failure" and "dishonesty," Old Bank funded two loans to an unqualified "straw buyer" who had no financial investment in the units and who in his applications for the loans materially exaggerated his income. Although Old Bank received a first-priority lien on each unit, Old Bank lacked the bargained-for benefit of an honest, diligent closing agent and a borrower both invested in the units and motivated to repay the loans. Also, although Old Bank successfully foreclosed on each unit and could have elected to pursue deficiency judgments against Ray, an elective, alternative remedy serves to affect, at most, only the measure of damages, not to prove the lack of a minimal causal relation between a corrupt closing and a lender's consequent loss. Undoubtedly, Old Bank's "actual loss" has at least a "minimal

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> causal relation" to Property Transfer's "failure" and "dishonesty."

The FDIC has brought scores of lawsuits against title insurers on Closing Protection Letters, all over the United States, seeking millions of dollars of loans that were made because of fraudulent appraisals.

Why don't title insurers just quietly absorb their losses on Closing Protection Letters like they used to?

They cannot afford to pay millions of dollars every year on risks for which they collect no money.

The losses paid by title insurers as a percentage of gross income has floated between 4.3% and 11.7% over the past decade. See the A.M. Best and ALTA chart.

Customers often say that the claims ratio for title insurance is too low. Those customers forget that title insurance is unique in that most of the premiums are spent to search and examine title. That portion of the premium is paid to title agents when they issue policies. Also, in Michigan, a title insurer pays a premium tax of 1.25% on the gross premiums collected, which includes the agent's split. This leaves a small portion of the premium from which the insurer must pay claims.

Using the chart above, assume that a title agent issues a policy on which the premium is $1,000 and the agent has an 85/15 split contract. The agent keeps $850. Thus, of the 88.9% shown as the composite expense ratio in 2012, the title agent takes 85%. The agent remits $150 to the underwriter. The insurer pays the State of Michigan $12.50 as premium tax. Using the average loss figures from 2012, the insurer would pay seven percent of the total premium, or $70, on claims. The underwriter gets to keep $67.50 on that $1,000 premium, with which to pay its agency staff, underwriters, rent and all other business expenses (including the salaries of the people paying the claims).

The losses paid by the title insurer on Closing Protection Letters also come from the $67.50 received by the underwriter on a $1,000 premium.

The better question is not why the insurers are no longer willing to issue Closing Protection Letters for free, but how this system has survived so long.

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Has a title insurer ever really gone out of business because of Closing Protection Letter claims?

Yes. Several have. The National Association of Insurance Commissioners is concerned enough about title insurers' ability to pay future claims that it formed a working group to study the issue. It issued the Title Escrow Theft and Title Insurance Fraud Whitepaper.

New Jersey Title Insurance Company, established in 1888, ceased operations in 2011 after incurred large losses on CPLs.

Guaranty Title and Trust Company was liquidated in 2008 after incurring CPL liability. The court cancelled all title policies.

Ninety-year-old Southern Title Insurance Company shut down in September, 2011, after suffering large CPL losses in Texas. The title agents in Texas paid an extra fee to cover those losses after the underwriter went out of business, as is discussed below.

When an agent steals money, does the title insurer pay everyone who is hurt?

No. The title insurer pays the parties who are protected under the Closing Protection Letter. This does not include sellers, refinancing borrowers, real estate brokers or other service providers who were to have been paid from the closing money.

If the title insurer has not issued Closing Protection Letters, it does not pay anyone whose money was stolen.

What other states have already passed Closing Protection Letter laws?

Recently, a number of states have imposed rules or laws requiring title insurers to issue Closing Protection Letters. Those states include Alabama, Arkansas, the District of Columbia, Delaware, Georgia, Idaho, Illinois, Louisiana, Missouri, Mississippi, North Carolina, New Jersey, Ohio, Pennsylvania, South Carolina, Tennessee, Utah and Virginia.

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What are the terms of other states' Closing Protection Letter laws?

Illinois recently adopted what has become the most-copied law of this type, which the insurance department wrote and imposed on the industry without its input or comment.

That law requires a title insurer to issue a Closing Protection Letter to all parties to the transaction: buyer, seller, lender and borrower. The law requires the insurer to charge for each letter, and sets the fee. The Illinois regulator's impetus for adopting the law was a series of thefts in which sellers and refinancing borrowers lost money without recourse against anyone other than the thief.

Issuance of Closing Protection Letters to non-insureds requires the adoption of a law because, without such a law, a title insurer does not have a basis for issuing a Closing Protection Letter to a party who will not be its insured under a policy.

What additional protection does a customer receive under a mandatory Closing Protection Letter law?

A law requiring a title insurer to issue Closing Protection Letters to buyer, seller and lender in a sale, or to both lender and borrower in a refinance loan, gives protection to people who cannot get that protection today because they are not insureds. Those parties are the seller and the refinancing borrower.

Do any of the Closing Protection Letter Laws allow the title agent to keep part of the Closing Protection Letter charge?

No. The regulators would not allow it.

First, the company for whom insurance is given cannot receive some of the premium paid for the insurance. That would be like your title agency getting a rebate of part of the premium you pay for an employee theft fidelity bond.

Second, if the title agent kept part of the Closing Protection Letter fee, this would increase the cost without any identifiable added service to the customer.

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How are Closing Protection Letters issued in split closings?

The insurer whose agent closed the loan issues a Closing Protection Letter to the lender-insured. The insurer whose agent issued the owner's policy issues Closing Protection Letters to the buyer and seller.

Doesn't a Closing Protection Letter law force my closer to tell everyone at closing that they are paying a fee in case my agency steals the closing money?

Not when the law requires that the Closing Protection Letter be issued to all parties. In Ohio, the law makes the Closing Protection Letter optional, and the closer has to explain the statutory opt-out form to the customer at closing. It is awkward to explain the coverage enough to inform the customer on what he or she is opting to buy or not buy.

However, those laws that make the charge mandatory require no such explanation by the closer. The Closing Protection Letter charge appears on the HUD-1 (soon to be renamed the Closing Disclosure statement). The closer simply explains that the letter is required by law and that it provides a protection against certain closing acts.

Doesn't a Closing Protection Letter law give a competitive advantage to branch offices over agents?

No, when the law is properly drafted. Most laws, including the Illinois law, require title insurers to issue Closing Protection Letters on all transactions, whether closed by their own branches or by agents. There is no additional fee paid by the customer to close with a title agent.

Can't title insurers eliminate the theft risk by

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conducting more escrow audits and making title agents observe the ALTA best practices?

Especially in the last decade, title insurers have learned what employee theft bond sureties have long known—that controls and audits limit the risk of theft and sometimes the amount of money stolen, but cannot eliminate the possibility of theft. No set of controls can ever prevent an employee or owner of a title agency from stealing escrow money. A theft can occur the day after an audit.

Also, the thefts have not been limited to people with no track records. Some of the people who have stolen money have been long-time industry members with excellent reputations.

Is there another kind of insurance or bond available in the insurance markets to cover the same risks covered by a Closing Protection Letter?

No. Secure Settlements offers a policy to lenders that supplements Closing Protection Letter coverage but does not replace it, which is mentioned in the National Mortgage Professional.

What are the alternatives to a law requiring the issuance of Closing Protection Letters to all parties?

There are other ideas for protecting customers. None of them have the same effect as a mandatory Closing Protection Letter law.

The other ideas are a guaranty fund managed by the state or a board set up by law, a law making a title insurer strictly liable for theft by a title agent, and centralized funding of loans by title insurers.

These options have been considered by the National Association of Insurance Commissioners, and can be found in the NAIC draft report.

The same options were discussed in a TitleNews article.

Any system that requires a law or regulation also requires the support of the regulator. The title industry does not have the ability to simply tell the

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Department of Insurance which option it should select. The more work and oversight a proposal would require from the Department, which has limited staffing, the less likely it is that the proposal would receive the Department's support.

What states have a guaranty fund, how would that kind of law work, and what are the good and bad points about that idea?

Texas is the only state that has such a fund.

According to its website, the Texas Title Insurance Guaranty Association ("TTIGA") "is a nonprofit, unincorporated association of all Texas-licensed title insurance companies. It exists to protect Texas title insurance policyholders and claimants when a title insurance company or agency fails."

Title agents pay fees directly to the TTIGA on all policies. Neither the customer nor the title insurer pays any fee to the guaranty fund.

TTIGA collects the policy guaranty fee from title insurance transactions to fund the title insurance agent audit function of the Texas Department of Insurance and to fund the payment of covered escrow account shortages resulting from the insolvency of a title insurance agent.

In 2014, the TTIGA collected a special additional charge to pay back insureds when underwriter Southern Title Insurance Company went bankrupt due to thefts by Texas title agents. A surplus was collected for the Southern Title disaster, so fee payments were suspended in 2015.

The TTIGA fund does not pay out unless a title insurer or agent goes bust. If an employee of the title agent steals money and the title agent covers that theft, the title agent may not collect from the TTIGA fund as if it were a fidelity bond.

The Texas TTIGA system is one part of the Texas regulation of the title insurance and closing businesses. Those regulations are the most comprehensive and stringent in the United States. They are very different from the Michigan regulations, which do not even cover the subject of closings and settlement services.

Texas sets the premium split between underwriter and agent. See P-23, Division of Premiums between Title Insurance Agents and Title Insurance Companies on

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TDI.Texas.gov. Another part of those regulations requires title agents and independent closing attorneys to put all closing funds in escrow accounts set up and constantly monitored by title insurers. Any benefits earned from those accounts go to the title insurer, not the agent. The agent does not get to select the bank that will hold its escrow account. The state has the right to audit the title agent's escrow files and account records. Also, every Texas title agent must maintain minimum capitalization standards. Every title agent must buy a bond that runs in favor of the state that protects the state in the event the agency is underfunded. Each year, the title agent must submit an audit report and its Title Agent's Unencumbered Assets Certification (Form T-S1).

Adoption of a Texas system for closings would require the adoption of a much more comprehensive set of rules than just the creation of a guaranty fund. At present, Michigan does not regulate escrows or the closing process or license closing agents.

What states have a strict liability law, how does that kind of law work, and what are the good and bad points about that idea?

Three states have strict liability laws. The laws differ from each other.

Florida law (Fla.Stat.Ann. § 627.792) provides that a title insurer is liable for the defalcation, conversion or misappropriation of settlement funds held in escrow by a licensed title insurance agent. Nebraska imposes strict liability on insurers for agent theft of closing funds. Neb. Rev. Stat. § 44-1993(8). Utah law makes a title insurance company directly and primarily liable to parties who deal with its appointed agents concerning the receipt and disbursement of funds deposited in escrows, closings, or settlements. Utah Code Ann. § 31A-23-308.

Some title agents have suggested that a strict liability law be adopted instead of a Closing Protection Letter law. Lenders do not see this as alternative solutions. They still demand Closing Protection Letters in the three states with strict liability statutes. One reason is that a Closing Protection Letter covers problems other than the theft of money by the closing agent. In the Florida FDIC decision discussed above, the closing agent did not steal any money, but the FDIC collected the full loan amount from the title insurer under the Closing Protection Letter.

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The biggest effect of a strict liability law is that the title insurer is directly responsible for money theft for every agent it appoints, on every deal it closes. The insurers place even tighter controls on all agents, including more frequent and invasive escrow audits. Agents are cancelled more readily when there is suspicious activity or a mishap, including theft by an employee even if the agent makes up the shortfall in the escrow account.

In what states do title insurers provide centralized loan disbursement, how does that system work, and what are the good and bad points about that idea?

Title insurers already do centralized disbursement in California, Washington, Oregon, Arizona, Utah, Nevada and New Mexico. This system is called sub-escrow. The escrow company or title agent handles the documents. The title insurer handles the money, especially the payoff of mortgage loans.

A title insurer can begin centralized disbursement for a lender in any state at any time. No law is required to "approve" this system. A title insurer charges a sub-escrow fee. In Michigan, escrow services are not regulated by the state. A title insurer would not be required to file its sub-escrow fees with any governmental agency.

In California, title insurers took over loan disbursements as sub-escrows after several well-publicized incidents in which employees or owners of independent escrow companies stole money deposited with them by lenders and buyers, hurting innocent parties. See Mark Sabbatini, Embezzlement Suspects Surrender: Escrow: Santa Clarita couple plead not guilty, in the LA Times and Notice to Potential Claimants of The Escrow Source by the California Department of Business Oversight. See also the Mortgage Fraud Blog for California Escrow Agent Arrested for Stealing from Escrow Accounts and Atwater Man Charged in Real Estate Fraud Scheme.

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