

SOUTHERN TITLE INSURANCE CORP.

P. O. Box 32099 • Knoxville, Tennessee 37930-2099

To: **All Southern Title Agents and Approved Attorneys**

Re: **“Residential Closing Funds Distribution Act of 2005” –
Questions and Answers - Compliance Guidelines**

Date: **August 30, 2005**

Beginning **September 1, 2005**, lenders and closing agents need to be aware of a new law that governs your receipt and disbursement of loan closing funds. On that date the “Residential Closing Funds Distribution Act of 2005”, (RCFDA), Public Chapter 273, becomes effective and imposes restrictions and obligations on both the lender and the closing agent. A complete copy of the bill can be accessed at:

<http://www.legislature.state.tn.us/bills/currentga/Chapter/PC0273.pdf>

The new law was supported by the Tennessee Land Title Association and Tennessee Bar Association to protect you, the closing agent, and all those who receive funds from you immediately after the closing. You and your clients should have the right to demand that you receive incoming loan funds in a form that will be deemed as “available for immediate disbursement” by your bank. The new law was designed to allow you to legally require your demands be met. Although the new Act does not perfectly meet all needs, it is a substantial step forward in the right direction.

One of the objectives of the RCFDA was to insure that consumers who request that closing proceeds be immediately disbursed could continue to receive such funds in a post “Check 21” era. The real estate industry in Tennessee has for many years employed a practice of disbursing funds at the closing table. Although closing agents in many states don’t disburse until days after a closing, in Tennessee, the real estate agents, sellers and lenders expect proceeds to be distributed immediately, regardless of the status of the closing funds. However, like it or not, this practice was accomplished through an improper use of the ‘float’ in the closing offices’ escrow accounts. This was never an advisable practice. Nevertheless, it is a recognized fact that closing funds in the form of a corporate check from a lender in Closing D, deposited on the day of closing, would not be recognized by the closing agent’s depository bank as ‘collected funds’ until several days after the date of closing. Therefore any checks given to the seller and others on the closing date of Closing D were really being paid and honored by the ‘float’ in the escrow account of remaining funds from Closings A, B and C that occurred days earlier.

Another objective of the RCFDA was to address the ethics of settlement disbursement practices. This issue has been a subject of concern for many years, but because of certain opposition in the Legislature by one particular legislator, the TLTA and TBA had been unable to address the issue legislatively. Lance Bracy of the Tennessee Board of

Professional Responsibility for years had ‘deferred’ action against real estate lawyers for the improper and unethical use of escrow funds in this fashion because of his knowledge of the inability to secure any legislative change. Last year, we were no longer faced with that legislator. Upon inquiry, Mr Bracy indicated that future deferral of disciplinary actions against lawyers would end unless closing attorneys could effectively secure legislation that would insure that disbursements at closing were from funds that were deemed ‘collected’ and available for immediate disbursement.

Another significant reason for the passage of the Act was to prohibit mortgage brokers from requiring that the closing agents accept their company checks as ‘collected’ loan funds. As you may be aware, there are a few mortgage brokers who are unscrupulous. These bad actors have made it a practice to give a check to the closing agent and not really have any funds to back the check at the time it was given. Then, based on their receipt of the note and deed of trust copy from the closing transaction, the note would be sold in the secondary market in exchange for wired funds to the broker’s account. At *that* time, a day or two after the check was deposited by the closing agent, the check earlier tendered as closing funds was ‘made good’. This practice was relatively widespread and subjected closing agents and their clients to immense personal risks.

Finally, the passage of “Check 21” occurred in October of 2004 and the industry realized that as banks begin to phase in the provisions of that Act, the net effect would be to substantially reduce the ‘float’ that existed in an escrow account. Since the ‘float’ was the key enabling element in the process of disbursement at the closing table, TLTA and the TBA saw a need for change.

As a result of these concerns, Tennessee Land Title Association and Tennessee Bar Association were faced with a decision to either try to change the standard of practice in Tennessee for the past 100 years and stop disbursement of closing proceeds for days after the closings had occurred or take steps to insure that the loan funds received were *available for immediate disbursement* under existing banking law. The TLTA legislative committee chose the latter as more consumer friendly and quite frankly less likely to create opposition from various special interests groups. The *initial* draft of the RCFD was filed to require all loan proceeds to be *solely* in the form of wired funds since that was the only form other than cash that was available for immediate disbursement. The initial draft submitted by the TLTA and the TBA didn’t last long.

The TLTA and TBA received input from the Tennessee Banking Association and the Tennessee Board of Realtors and, as a result of their collective lobbying; the bill was modified to include, among other things, a number of other forms of checks. Restrictions were placed on some forms of checks in an attempt to insure the other allowed checks would be *as close as possible* to our ultimate goal of receiving funds that would be available for immediate disbursement. The current statute language is a compromise result of the combined efforts from the Tennessee Land Title Association, Tennessee Bar Association, Tennessee Board of Realtors, Tennessee Bankers Association and the Tennessee Board of Professional Responsibility.

It should be noted that the Tennessee Bankers Association was actively involved in, and ultimately approved, the language in this bill. Some lender's recently raised complaints about the Federal Reserve check clearing region restrictions on Teller's or 'other official checks' in the bill should not be directed at TLTA or TBA. That particular language which appears in the bill was their association's suggested and approved text.

How will the new Act affect a closing agent's practice?

If you currently receive your closing funds via wire, or in the form of a "Cashier's" check, the new Act has absolutely no impact on your practice...it's business as usual. Much discussion has taken place in the past weeks about the new Act and how it will create problems receiving lenders funds. But the truth is that every lender, whether it is a mortgage company, mortgage broker, bank, savings and loan or credit union can wire loan proceeds. Maybe not all lenders can issue or secure a Cashier's check, but they can all wire funds. There is no reason for the loan funding process to be slowed or halted as a result of the new Act...wired funds will always allow the transaction to proceed.

However, if a lender doesn't want to wire and can't issue a "Cashier's" check, there are still some limited cases that a lender can issue their own "Teller" or other "official" checks (subject to rules as described below). In spite of these additional allowed check types, it is true that some lenders, maybe even some large lenders, are accustomed to utilizing checks that are not permitted under the new Act....life will not come to an end. They will merely have to change their old procedures and most likely adopt a new practice of wiring funds.

Remember, a lender may not *want* to wire funds, or issue a Cashier's check, or provide an acceptable check, but they do not have a legal option to compel you to take anything else. Likewise, you do not have a legal option of accepting anything but one of the forms of funds indicated in the Act. Neither of you has the right to ignore the new law. And there are substantial penalty provisions in the Act that were designed to elicit compliance.

What good does the RCFD Act accomplish?

The RCFD Act was intended by the TLTA and the TBA to reduce the ever increasing risks that in the past you, and your clients, have been forced to incur in handling and disbursing escrow funds. However, there is no denial that the achieved safeguards will also result in some new restrictions on your practice that may be aggravating to lenders, your office personnel and some clients.

In a nutshell, the new law requires lenders to fund *residential* loan closings in a fashion that reduces risks to your office when you disburse loan proceeds at, or very soon after, the closing is completed. For attorney closing agents, Lance Bracy has indicated that compliance with this Act will constitute compliance with an attorney's ethical standards.

For all closing agents, the new Act means you will no longer be legally required, or *illegally/competitively pressured*, to accept 'drafts' or other types of checks that under current banking law are not deemed 'collected funds' for days or even weeks after you deposit them

into your escrow account. You will no longer be compelled to take the buyer's or seller's check for thousands of dollars because they came up short at closing. You now have a statute that you can point to that prohibits you from having to absorb the risk of those types of checks being returned unpaid. Finally, since competitors, attorneys and non-attorneys, have to play by the same rules, this should allow lenders doing business in Tennessee to receive a uniform message that will encourage compliance. Since the new Act contains substantial penalties for violations, it makes it likely most closing agents won't be tempted to 'cave in' to a lender's request to treat them differently.

With this new Act, the TLTA and the TBA have responded to the constant call for a 'level playing field' that applies evenly to lawyers and non-lawyers just as it applies to home town banks and out of state mortgage brokers.

What new problems does the new law cause?

Many have commented that the new Act is going to make closings in areas where "split closings" are common to cause the party handling one side to wire funds or secure cashier's checks to transmit monies that were previously just handled by simple escrow check. Others have lamented about the need to wire funds or secure cashier's checks to fund seller's proceeds whenever those proceeds will be used in an immediate 'back to back' closing. Some loans may be delayed because the buyers (or sellers) need to bring more money to closing than the allowed up to \$1,000 personal check. Some realtors whose escrow accounts are not in the same Federal Reserve check clearing district will not be able to use a company check at closing. Admittedly, the new Act will result in these types of problems and may require some changes in your business practices.

However, it is anticipated that over the next few weeks that the marketplace will address all of these challenges one way or the other. Most of the time the solution is just a little better planning on the front end and perhaps some minor delays. Ultimately, no transaction will be lost...delayed maybe, but all transactions can still occur. But it is important to remember the reason for whatever aggravation or delays that may occur – the new Act was designed to help closing agents and consumers minimize the risks they have been forced to absorb in the past.

What is the easiest way to insure compliance with the new Act?

Just get your lenders to provide loan funds in the form of wired funds or Cashier's checks. Public Chapter 273 provides that if the funds are in the form of:

- (A) Cash;
- (B) Wired funds;
- (C) Checks issued by the "State of Tennessee or a political subdivision of the state";
- (D) Cashier's check;
- (E) Checks issued by "an instrumentality of the United States organized and existing under the Farm Credit Act of 1971, as amended",

then the funds can be from an account in any Federal Reserve District. With any of these listed checks, you never have to be concerned on the Federal Reserve routing numbers, etc.

When do I need to be concerned with the Federal Reserve processing region when accepting closing funds?

The new Act says that if the funding check is one of the following types:

- (1) Teller's check or "other official check, however designated", which is issued by a financial institution, or
- (2) if you accept as part of the funding checks issued from the "escrow or trust account of a licensed real estate broker"

then you must verify it is drawn on or payable through a financial institution within the "same Federal Reserve check processing region as the location of the settlement agent." The reason for this requirement is that these types of checks from outside your region can take much longer to clear in order to be deemed 'collected' by your bank.

How can you tell if a check is drawn on or payable through the "same Federal Reserve check processing region as the settlement agent?"

Appendix A to Part 229 of Title 12 of the Code of Federal Regulations provides the following explanation about Routing Numbers

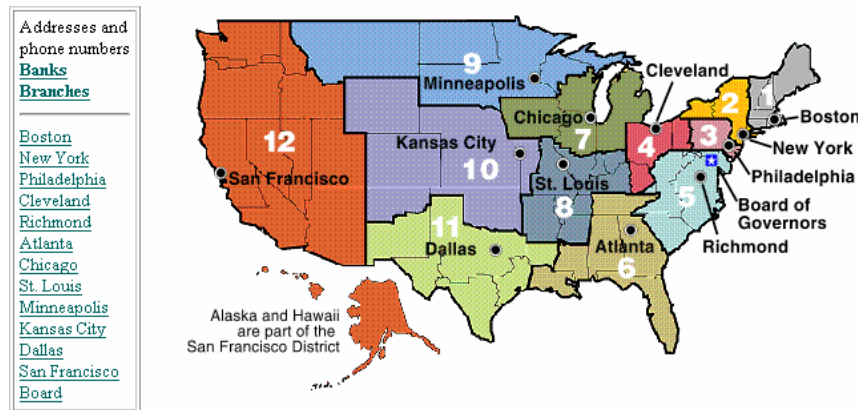
"Each bank is assigned a routing number by an agent of the American Bankers Association. The routing number takes two forms: a fractional form and a nine-digit form. A paying bank generally is identified on the face of a check by its routing number in both the fractional form (which generally appears in the upper right-hand corner of the check) and the nine-digit form (which is printed in magnetic ink along the bottom of the check). Where a check is payable by one bank but payable through another bank, the routing number appearing on the check is that of the payable-through bank, not the payor bank.

The first four digits of the nine-digit routing number (and the denominator of the fractional routing number) form the "Federal Reserve routing symbol," and the first two digits of the routing number identify the Federal Reserve District in which the bank is located. Thus, 01 will be the first two digits of the routing number of a bank in the First Federal Reserve District (Boston), and 12 will be the first two digits of the routing number of a bank in the Twelfth District (San Francisco). Adding 2 to the first digit denotes a thrift institution. Thus, 21 identifies a thrift in the First District, and 32 denotes a thrift in the Twelfth District."



The Federal Reserve Board

The Twelve Federal Reserve Districts



Unfortunately, as the chart above reflects, two different Federal Reserve Districts serve the state of Tennessee. The graphic indicates that both the Sixth and Eighth Districts affect Tennessee. According to the paragraphs noted above, the first 2 digits of routing numbers on checks will have one of 4 possible combinations: 06, 26, 08, 28.

Depending on the settlement agents' location in the state, each agent will only be concerned with 2 of these 4 numbers, i.e., if you are located somewhere east of Jackson, or anywhere east of there, you will be looking for checks with **06** or **26** in the routing numbers. If you are located around Jackson all the way west to Memphis, you will look for **08** or **28** on your funding checks. If these appropriate numbers appear on the check transmitted to you, the check is "within the same Federal Reserve check processing region as the settlement agent" as required by the new statute.

Where do you look for the Federal Reserve routing numbers?

The location varies based on the type of check, but the Federal Reserve provides the following graphic to make it a little easier to understand. Please note the location differences for personal and business checks.

Personal Check

The diagram shows a personal check with the following fields: "Pay to the order of _____", "_____ 19__", "_____ | \$ _____", "_____ dollars", "(Bank name and Location)", "123456789", "0000000000 000", and "_____". A box highlights the routing number "123456789" and a line points to it with the label "Routing number".

Business Check

The diagram shows a business check with the following fields: "Name of Company", "Address, City, State", "_____ 19__", "Pay to the order of _____", "_____ | \$ _____", "_____ dollars", "(Bank name and Location)", "000000000", "123456789", "0000000000 000", and "_____". A box highlights the routing number "123456789" and a line points to it with the label "Routing number".

The first 2 digits of the Routing numbers that appear on a funding Teller's or Official check will need to match the numbers that are associated with the location of your office, (presumably your escrow account's banks' region). Remember, these requirements do not apply to Cashier's checks!

How do I advise my lenders from out of state of the change in the law?

You may not need to send anything to a lender whose practices are already in compliance with the requirements of the new law. In order to advise non compliant lenders of this change in the law, it would be advisable to send a notice to the lenders that you currently service advising them of the new law. It is suggested you send a notice of the new law to the lenders you routinely service and then attach a notice with any new Insured Closing Service Letters you send to new lenders. While any language will suffice, attached is a single page notice that should be sufficient for these purposes. This type of notice is designed to ‘encourage’ the use of wired funds or Cashier’s checks but acknowledges the possibility of other checks being deemed acceptable if pre approved.

Does the new Act eliminate all risks of handling loan funds.

While the new Act is a step in the right direction, please be aware that your bank has the *right* under Regulation CC of the banking laws to impose ‘hold’ periods on funds deposited into your escrow account. These hold periods could be for as little as one day to up to or over a week. Most banks provide their regular title company/law firm customers much quicker availability to deposited funds than the periods allowed under Regulation CC, but acceptance of funding checks and immediately disbursing to sellers and Realtors can still pose a risk. The best insurance against bank policies causing you a problem is to develop a good relationship with the banker who is responsible for your escrow account. Banks value real estate escrow account relationships and should work hard to accommodate your practice.

Overall, this Act will reduce your risk of handling escrow funds, but in the short term you may experience some increase in aggravation, delays and frustration on the part of lenders and clients. Hopefully, these problems will subside as all parties become aware of what they need to provide and make suitable arrangements to comply with the law.

The TLTA and the TBA realize that the *compromise* version of the new law is not a perfect solution for all closing offices and all situations. However, these organizations are committed to working with the real estate closing community to provide the best possible solutions to our ever changing marketplace.

Note: A sample “Notice to Lenders” appears on next page

NOTICE TO ALL LENDERS

New law effective September 1, 2005 that affects how Lenders are required to fund real estate loans involving Tennessee properties

Pursuant to Public Chapter 273 of the Public Acts of Tennessee 2005, lender's funds for all residential loan closings now must be received by the settlement agent **at or before** closing (or day after expiration of ROR in case of Refis). The new law prohibits settlement agents from accepting certain *types* of checks and/or checks drawn on banks *outside* the Federal Reserve check clearing region of the settlement agent. However, to avoid any confusion, and minimize closing delays, just remember wired funds or "Cashier's Checks" are always acceptable and permitted under the new law.

**In order to comply with the new law in Tennessee, closing funds should only be transmitted by wire
or
delivered via Cashier's check.**

Other forms of funding may not be acceptable and will require advance approval before use. Contact your settlement agent before funding.

The new law applies to all residential purchase and residential refinance loan closings involving property located in the State of Tennessee.

Any violation of this statute may result in a *minimum* fine of \$1,000 to a lender and/or settlement agent.

You may contact the Tennessee Department of Financial Institutions at 615-741-2236 if you have any questions.

To view a complete copy of the new Act, go to:

<http://www.legislature.state.tn.us/bills/currentga/Chapter/PC0273.pdf>
