

Lender's Closing Instructions and Texas Department of Insurance's Procedural Rule P-35

I. Introduction

Federal lending regulations have encumbered the closing process and made it increasingly complex for the lender, title company and, in my opinion, consumer. In addition, the Texas real estate economy has out-performed other states resulting in a proliferation of out-of-state lenders doing business in Texas. Each lender has its own set of closing instructions, most of which do not recognize our own unique set of state laws and/or title insurance rules and regulations. As a result, the role of the escrow officer and title agent has evolved, and the title industry has been forced to assume much more liability than it already accepts under the contract of title insurance. An escrow officer handling closings of residential and commercial transactions today must keep up with all the new laws and title insurance forms, be very familiar with all the new title endorsements – to which policies they apply, their coverage and costs – and stay informed as to new lending requirements. Further, an escrow officer must be alert to lender closing instructions that may not comply with our particular set of rules and regulations and/or state laws and require revisions to those instructions before closing.

As much as the title industry is careful not to assume more liability than it already assumes under the contract for title insurance, there is a continuing push to make the title company responsible for insuring all of the lender's underwriting requirements are met. After all, the escrow officer is often the last line of defense. However, the Texas Department of Insurance's Procedural Rule P-35, which states, "No Title Insurance Company, Title Insurance Agent, Direct

Operation, Escrow Officer, nor any employee, officer, director or agent of any such entity or person, shall issue or deliver any form of verbal or written guaranty, affirmation, indemnification, or certification of any fact, insurance coverage or conclusion of law to any insured or party to a transaction other than: (i) a statement that a transaction has closed and/or has been funded, (ii) issuance of an insured closing service letter, or any insuring form or endorsement promulgated by the Texas Department of Insurance, or (iii) certification of copies of documents as being true and exact copies of the original document or of the document recorded in the public records," was enacted to prevent the imposition of extraordinary liability on title agents and escrow officers due to specialized closing instructions from the lender.

A majority of lender's closing instructions require the title company to postpone closing unless it can certify to certain facts or give affirmative coverage. Often these facts are not readily known or easily discoverable by the title agent or escrow officer, and the Texas Department of Insurance prohibits the giving of affirmative coverage.

This outline will focus primarily on how the title agents and escrow officers handle lender closing instructions, the interplay of Insured Closing Letters and the future of closing instructions.

II. Defining Procedural Rule P-35 and Commissioner's Bulletin # B-155 (Attachment 1 and 2).

A. Procedural Rule P-35:

Procedural Rule P-35 is titled Prohibition Against Guaranties, Affirmations, Indemnifications and Certifications. Under Procedural Rule P-35 escrow officers must take caution to avoid issuing or delivering any form of verbal or written guaranty, affirmation, indemnification, or certificate of any fact, insurance coverage or conclusion of law. The escrow officer must closely monitor

what they are being asked to sign and what they say to vendors and customers during contract pendency, as well as in the closing room.

B. Texas Department of Insurance Commissioner's Bulletin # B-155:

In 1991, Commissioner's Bulletin #B-155 was published to shed light on Procedural Rule P-35 with respect to HUD-1 Settlement statement amendments that were released. Although the referenced changes to the HUD-1 Settlement Statement are no longer new, Bulletin # B-155 provides an interpretation of Procedural Rule P-35 and closing instructions that still rings true today, 30 years later.

Bulletin # B-155 states, "Procedural Rule P-35 was enacted to prevent the imposition of extraordinary liability on title agent or escrow officers due to specialized closing instructions. The rule is not intended to prohibit title agents or escrow officers from following the terms of and acknowledging receipt of standard closing instructions, provided that no certification or guaranty is included or implied in the acknowledgment of receipt. The rule applies to all real estate transactions, including commercial transactions, residential transactions, and instructions from lenders or attorneys." It goes on further to state, "Any acknowledgment of receipt of the closing instructions does not imply a certification or guaranty of fact, insurance coverage or conclusion of law."

As a result of the interpretation of Procedural Rule P-35 and the prohibition of affirmative coverage from the Texas Department of Insurance, escrow officers are taught to stamp every closing instruction with a P-35 Stamp and never sign the instructions. The issue becomes whether or not the stamp provides adequate protection, as required under Procedural Rule P-35, from increased liability imposed on escrow officers and title agents.

III. What is Allowed and Prohibited by Procedural Rule P-35 (Attachment 1)

A. Allowed for under Procedural Rule P-35:

Procedural Rule P-35 permits (1) a statement that a transaction has closed and/or has been funded; (2) issuance of an insured closing service letter, or any insuring form or endorsement promulgated by the State Board of Insurance; or (3) certification of copies of documents as being true and exact copies of the original document or of the document recorded in the public records.

B. Not Prohibited Under Procedural Rule P-35:

Procedural Rule P-35 does not prohibit (1) certification relating to disbursements on the HUD-1 by the title agent or escrow officer; (2) acknowledgment of receipt of closing instructions; (3) escrow officer from signing a statement saying a set of standard instructions were read by and is familiar to the escrow officer; or (4) escrow officer from following or applying standard closing instructions.

C. Prohibited Under Procedural Rule P-35:

Procedural Rule P-35 prohibits the escrow officer or title agent from (1) certifying that proceeds were disbursed according to a special set of instructions; (2) certifying they personally closed the transaction in accordance with special instructions; and (3) signing first lien letters that certify the status of the lien at closing.

IV. P-35 Stamp and Escrow Officers' Fiduciary Duty

A. P-35 Stamp

Rather than evidencing acceptance of the lenders closing instructions by signing them, the escrow officer affixes the P-35 stamp. The P-35 stamp reads "We are prohibited from executing this document inasmuch as the

Texas Department of Insurance requires all statements made by title companies to be on promulgated forms only". While the intent of the P-35 Stamp was to prevent extraordinary liability imposed on the title agents and escrow officers, unfortunately, some escrow officers read this rule and falsely rely on the stamp to relieve the escrow officers from liability for failure to comply with lender closing instructions.

B. The Court's Ruling on Fiduciary Duty (Attachment 3)

It was made clear under the ruling in Home Loan Corp. v. Texas American Title Co., 191 S.W.3d 728 (Tex. App. – Houston 2012 Texas Land Title Institute – Closing Problem Spots Page 2 [14th Dist.] 2006, pet. denied), that a title company owes a fiduciary duty to the lender, one of the highest duties allowed by law, to close according to the lenders closing instructions. After the ruling in Home Loan Corp., lenders began inserting additional instructions such as "THIS LOAN IS SUBJECT TO THE REAL ESTATE SETTLEMENT PROCEDURES ACT (RESPA): "... a condition of our consent to your closing this transaction is that you accept these instructions and complete and deliver the HUD-1 Statement in accordance with such requirements. If you do not accept this condition, please return these Lender's Closing Instructions and all documents immediately." Many lenders even go so far as to include instructions that read: "You are responsible for the proper preparation and/or execution of: all legal documents, necessary notarial acknowledgments, Borrower/Seller closing statements, Fannie Mae/Freddie Mac uniform instruments, FHA/VA Note and Security Instrument and any other requirements listed on the Closing Instructions." And, "The undersigned settlement agent hereby agrees to reimburse _____ for any penalties it may incur as a result of settlement agent's errors and/or noncompliance with these instructions." As is evident, such closing instructions go too far in shifting responsibility and liability to the

escrow officers. Even with a stamp, if the escrow officer closing a transaction where the Lender's Closing Instructions state do not close unless you can comply, but the escrow officer cannot comply but closes anyway, the liability may be found to be imposed on the escrow officer or title agent.

V. Mortgage Industry Standards Maintenance Organization (MISMO) and the Future of Closing Instructions.

MISMO is an organization that aims at providing a common language and platform for the mortgage industry to exchange information. MISMO is a subsidiary of the Mortgage Bankers Association. Its mission is to lower costs, reduce communication issues, increase efficiencies, provide for innovation, improve compliance with counterparties and regulations, and reduce fraud. One of the many areas that MISMO is trying to help the mortgage process is through Standardized Closing Instructions.

Many times, escrow officers do not receive closing instructions, which can be very lengthy, until shortly (sometimes less than thirty (30) minutes) before the Borrower walks through their door to sign the documents. This is not enough time for the escrow officer to thoroughly review the closing instructions and discover affirmative coverage issues or particular requests inconsistent with the issued Texas commitment. As such, escrow officers always lean toward stamping closing instructions whether Procedural Rule P-35 prohibited items are in the instructions or not. With the help of MISMO's promulgated closing instructions the escrow officers and title agents will more clearly know what is acceptable to sign and what needs a P-35 Stamp.

MISMO has been working closely with the settlement services industry, including organizations such as American Land Title Association and the Mortgage Bankers

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