

Welcome!

TDI Update
by John Rothermel

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Note: PowerPoints and audios for the June **Privacy Issues** webinar, and the New Forms and Rules webinar are now available at www.stewarttexas.com

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TDI Update
as of July 18, 2008

John Rothermel
Stewart Title Guaranty Company
Web Conference Series 2008



Mineral Interest Bulletin

- Commissioner's bulletin (withdrawn)
 - Deals with general exceptions under P-5
 - Would have been almost ok if it hadn't gone farther than mineral exceptions
 - "the insured estate must be the same as contracted for in the sales contract"

STG Filed For Withdrawal and For a Hearing

- In reaction to the bulletin, STG filed a motion with the commissioner for the bulletin to be withdrawn and that a hearing be held asap to consider a new rule that clearly allows for general mineral exceptions.
- TLTA joined this request after a few days.

Department Responds

- TLTA created a task force to consider industry options in this area. Task force met and then met with the TDI.
 - Commissioner Geeslin attended 2 meetings and stayed for nearly an hour... an almost unheard of amount of his time. Hats off to the commissioner.
- TLTA created a compromise position amending P-5 and P-50.

P-5 & P-50 Amendments

- P-5 would be amended to specify that title companies make the insurability decision, not the parties to the contract. It also allows special exceptions based on its underwriting standards.
- P-50 proposal would allow T-19.1 coverage to be available to residential property.

P-50 Revision Amended

- As part of the discussion process, the TLTA task force approved a refinement to the P-50 proposal to create a new T-19.2 just for mineral exceptions.
 - No charge

TDI Responds

- Bulletin withdrawn
- Hearing date set for July 15, 2008

STG Responds

- STG agrees with the basic TLTA approach but has philosophical difference since P-5 revision doesn't specifically address the general mineral exception.
- STG works on further compromise with TLTA to give broader coverage (T-2r language) to slightly fewer folks (1 ac in platted residential subdivision).

TLTA Responds

- TLTA and STG and finally IBAT agreed on compromise language that
 - Left P-5 intact (as P-5a).
 - Added P-5b that allows title company to make decision re insurability and then authorizes general exception for minerals.
 - Added P-5c that allows title company to make decision re insurability generally.
 - Added P-5d that requires easements and restrictions to be searched for and specially excepted.

At the Hearing

- Industry parties presented a strong, viable case.
- Lawyers opposed (commercial and residential).
- OPIC opposed without (the standard 25%) rate credit.
- Commissioner appears to have sent a signal and gave 14 days to compromise.
 - Mentioned that this was a confluence of real, mineral and title law and needs.

A Compromise in the Works?

See disclaimer

- **P_5.1. Use of general exception regarding minerals**
- Notwithstanding the provisions of P-5, a company may insert into a title insuring form the general exception for minerals set out in subsection b of this rule upon the following circumstances:
- For a mineral search, the company may begin its search at a current date and search back toward the sovereignty of the soil. When the company discovers a mineral severance or evidence of a mineral severance, grant, lease, exception or reservation, it may assume that minerals are outstanding and insert the general exception for minerals.
- The company shall have no obligation to determine if the grant, lease, exception or reservation was of proper legal effect, including without limitation, whether the individual asserting the grant, lease, exception or reservation actually owned all or any part of the minerals.
- The company shall provide a reference to the recording information of the document severing or purporting to sever the minerals.

A Compromise in the Works? P2

See disclaimer

- The following general exception for minerals shall be used in compliance with this rule P-5.1:
- All leases, grants, exceptions or reservations of minerals or mineral rights appearing in the public record evidence of which is found in _____ (name of instrument) dated _____ and recorded in Vol. ____ page ____ of the Records of _____ County Texas.

A Compromise in the Works? p2

- **Disclaimer:**
- The preceding 2 slides are copies of a working draft proposal not approved by STG, TLTA or any other party but may form a basis for discussion of a compromise. These slides should not be distributed to anyone outside your title company or be held out as a final document. Please be aware that the language could change at any moment without notice or never be filed.

Other Matters

- Commissioner appoints an advisory committee
 - Composed of cross-section of industry, agents and underwriters as well as TDI senior staff and counsel for guaranty association and OPIC representative
 - Groups hold numerous meetings and sends report to commissioner

Agency Solvency

- CAUSES OF TITLE AGENCY INSOLVENCIES
- There is little research or empirical evidence relating to the cause of title agency insolvencies but the WG possessed more than enough practical experience to provide sufficient anecdotal evidence to identify the following causes:
 1. Insufficient capital.
 2. Insufficient or improper management.
 3. Fraud or defalcation.
- Deteriorating market conditions are often cited as a cause of insolvency, but actually, **market conditions probably only make it likely that agencies suffering from one of these three causes will fail. Well-run and well-capitalized agencies routinely survive market downturns.** It is important to note that many of the title agencies that become insolvent either repair their financial condition or retire from the business without any negative impact on the public. This process is managed through the actions of the agencies, the underwriters, and TDI in accordance with the Title Manual. Potential harm to the public occurs when this system breaks down as the result of the inability or unwillingness of one or more of the parties to cooperate in the process.

Agency Solvency

- Improve TDI's internal procedures for responding to early warning indicators. For example, insufficient books and records are a hazardous financial condition providing a legal basis for immediate response by the Financial Division under the Hazardous Financial Condition rule, 28 TAC Sec. 8.3(17). The same would be true for a report identifying an insolvency, but we feel the key is an immediate response, and intervention, if necessary, to guarantee the integrity of and access to the books and accounts of the agency.

Agency Solvency

- It became clear during the deliberations that the underwriters could do a better job of securing timely reporting of policies and premiums and that sharing that information with the Title Division would be helpful in identifying agencies that might be having financial difficulty. As part of the deliberations by the WG, a new and expanded R 2 letter was developed and sent to underwriters to secure additional information. The WG concluded this was the only immediately available tool for underwriters to assist the Title Division in securing additional information. However, the WG recommends that expedited reporting of policy issuance, payment of premiums, and reporting of business to underwriters should be required of underwriters and agents, subject to the resolution of the threshold issues cited above.

Agency Solvency

- Title agents should be required to segregate the underwriters portion the title insurance premium in a premium trust account. Deposits to the trust account would be made at the closing of the transaction. The consensus of the WG is that only one premium trust account should be required regardless of the number of underwriters doing business with the agency and the agent should be entitled to any income earned on the account. The premium trust account would be labeled a "trust" account to designate the funds are held for the underwriters, as a fiduciary, but would not be an escrow account. Monitoring of these accounts by the underwriters will provide an early warning of potential financial problems that could then be pursued by a targeted audit.

Agency Solvency

- *Title Agent Financial Reporting.* The Department can request specific financial information, such as a balance sheet certified by the President of the agency under Sec. 38.001, but this information is not protected from disclosure as open records unless it is determined to be proprietary or a trade secret. It is unlikely that agencies will endorse such additional reporting unless they can be assured by the Attorney General, or some other provision of the law, that the information will not be available to competitors and other third parties. If protection from disclosure can be secured by an Attorney General opinion then this recommendation could be implemented immediately. If not, the Legislature may have to impose this requirement and provide the required confidentiality. This requirement could also be expanded to require certification of the balance sheet by the agency's certified public accountant with a simple affidavit. Consideration should be given to expanding the agent report to include the number of closings, premium splits, and similar information. These reports could be quarterly, or more frequently if the agency met certain specific criteria meriting closer scrutiny. This information could be used for early warning as well as for targeting agents to be audited.

Agency Solvency

- *Targeted Examinations.* We believe the audit process can be streamlined and focused to provide better information on the state of title agents in a timelier manner. For example, we discussed the development of an audit protocol that focused the audit resources on those agents most likely to have problems, such as new agents. The protocol could provide that agencies with more capital are examined less frequently as is the case with insurance companies. Another incentive to build into the protocol is that agents with fewer complaints and errors would be audited less frequently. We discussed the possibility of using a grading system like that employed by the Banking Department. This procedure raised some legal issues but probably merits additional research and consideration as a part of the audit protocol. An additional suggestion for the protocol was enhanced scrutiny of affiliated business arrangements and single source of business only agencies. Consideration should be given to requesting additional resources for the audit process.

Agency Solvency

- *Expedited Enforcement of Violations That Could Lead to Insolvency.* While mindful of TBI's limited enforcement resources, it is clear from our deliberations that timely action by the Legal Division on referrals from the Title Division is critical. Even a letter from a staff attorney can have a dramatic impact on a title agent. If the agent knows the Department is closely monitoring compliance further deterioration of the agency's operation, and a potential insolvency, might be prevented. We would like to see routine violations handled expeditiously perhaps according to a schedule of fines or summary process so that staff time can be freed up for the more difficult cases. License revocation and other enforcement actions are clearly necessary, but are not effective for preventing insolvencies because of the time required to complete the process. However, the protection of books, accounts, and escrow funds should be a routine part of any enforcement proceeding and especially the settlement of any such proceeding. OPIC and other WG members specifically oppose the concept of a schedule of fines because all fines should be based on the totality of the circumstances and the hands of the enforcement division should not be tied by such a schedule.

Agency Solvency

- *Enhanced Licensing Requirements.* Essentially, it is the judgment of the WG that is just too easy to get a license as a title agent. As a result, we recommend the following enhancements to the licensing process:
 - Creating a capital and surplus requirement to insure the agent has the financial resources to weather market downturns. (statute?)
 - Requiring agents to maintain employee dishonesty and related insurance coverages in sufficient amounts to prevent defalcation or fraud from creating an insolvency. (statute?)
 - Increasing the amount of the required bond in proportion to the amount of funds for which the agent is responsible. (statute?)
 - Specifying the level of management experience and expertise required to secure the license and insuring it is maintained. (rule?)
 - Requiring accounting experience and expertise relevant to title agencies and requiring it be maintained. (rule?)

Agency Solvency

- The WG recommends applying these new standards to currently licensed agents with due consideration to grandfathering or phasing in some requirements. For example, when the minimum capital and surplus was increased for insurance companies, the requirement was phased in over 10 years. Caution should also be given not to burden agencies unduly and consideration to the size of their market, volume, and other relevant factors should be part of any enhancement formula.

Other Issues

- *Education of Underwriters and Agents.* The WG felt that more training and communication is required such as the development of a best practices guide for agents and underwriters, training programs for title agency managers and accountants, continuing education programs for all key agency personnel. The underwriters expressed a willingness to assist in the development of educational programs and suggested the Texas Land Title Association could have a role in providing such programs.

Other Issues

- TTIGA is not likely to learn of agency financial issues at an early stage except through the industry members of its board. It already has a statutory obligation to report any such information and making the solicitation of that information in a form that is legally protected could be a part of each of its meetings, with communication to the Title Division of any relevant information. In addition, TTIGA has information on the reporting of guaranty fees which may provide additional insight on the operations of title agents. TTIGA reports this information to the Title Division on a quarterly basis, but the publication of guaranty fee reporting and related issues by TTIGA might also be useful.

Other Issues

- *Record Retention and Protection.* The files of the title agent are important to the agency, the underwriter, and TTIGA. Each of these parties also needs to have access to the records to conduct their business. Currently, there is no statute or rule addressing the ownership of and access to records when an agency retires from the business involuntarily. This void needs to be filled with a rule clearly addressing ownership as well as the responsibility for maintaining the files and the authority for one or more of the parties to assume control in the event one of the others falters. The expense of securing and maintaining the records in these situations should also be specifically addressed. These records also need to be protected from landlord and storage facility liens, at least to guarantee access for servicing the business and paying claims. This additional protection will probably require action by the Legislature. There is a strong feeling that the use of electronic records will reduce costs, enhance the necessary protection of these records, and provide the opportunity for more efficient access. The WG also felt that a review of file storage arrangements should be part of the TDI audit process.

Other Issues

- *Underwriter Role.* The underwriters in the WG expressed a willingness to monitor their agents more closely if there were clear standards that applied to all underwriters so that the monitoring, or lack of monitoring, could not be used to a competitive advantage. Underwriters should be required to establish systems to secure timelier reporting of premium and the issuance of policies. Policy systems should be required to track policies and insure timelier issuance so agents cannot warehouse policies. The same should be required for premium reporting. Consideration should be given to the responsibilities of underwriters for the actions of their agents. Currently underwriters are required to audit agencies every two years. More frequent audits, even if limited in scope, would clearly provide the opportunity for more accurate information. This requirement could be added by rule, or perhaps by a rule that required certain provisions in the contract between agent and underwriter. One of the required contractual provisions would be more frequent audits and authorization to report the results to the Department. Other required provisions might include a requirement that the escrow account be reconciled more frequently, where costs and available technology make it practical.

Personal Property Insurance

- Personal Property insure approved for use in Texas
- Statutes passed to allow
- Rules hearing on forms
- Contested Rate hearing at SOAH
 - OPIC objected to rates based on lack of Texas experience
 - On forms never before offered in Texas!!

Personal Property Insurance

- Hearing took 2 days, had 3 industry parties and probably a dozen witnesses
- Fidelity, First American and Stewart each presented their cases and rates
- Concepts, forms, coverages and rates are all different

Personal Property Insurance

- Any licensed title insurer can issue the forms presented by either of the 3 companies
 - Must charge the rates approved for that company's forms
 - STG can issue FAM; ORT can issue STG

Personal Property Insurance

- What essentially is covered?
 - Personal Property Title Insurance insures the lien priority of a UCC filing on personal property used by a borrower a collateral for a loan.

Personal Property Insurance

- What does the title agent do?
 - The agent refers the order to STG Glendale California.
 - Period.
- Why should I do this?
 - The agent receives a 30% commission when the transaction closes and funds.
 - For simply referring the order.
 - Now, the rates are lower but the policy amounts are averaging \$25 million so there is some real money to be made.

Personal Property Insurance

- How does the underwriter search my records?
 - They don't. The only records searched are those in the secretary of state in the state in which the borrower is incorporated or does the substantial amount of its business.

Personal Property Insurance

- What kind of transactions get PP title insurance?
 - Computer data centers, refineries, office building, warehouses, and shopping centers.
 - Anything that if you shook the building and something falls out.

Personal Property Insurance

- Are consumer goods covered?
 - No. Consumer goods are dealt with in a different section of the Uniform Commercial Code. This line of insurance is inapplicable to them.

Personal Property Insurance

- If I am providing title insurance on the land and improvements, does the underwriter get a piece of the deal?
 - Only the 15% of the land title insurance policy.

Personal Property Insurance

- What's the catch?
 - For a Texas agent, there really isn't one.
 - You simply need to be on the look out for appropriate transactions (inventory or lots of stuff for which the lender doesn't want title insurance protection).
 - Even if the lender hasn't asked for PPTI, get the information to Mike Choy (Mchoy@stewart.com) and let him sell the lender.

Rate Hearings

- Spring 2008 Rate hearing cancelled because of uncertainties in the real estate market.
- Fall 2008 Rate hearing tentatively set for late October or so.
- Way too early at this stage to predict what will be the result or even the recommendations.

Legislature

- Sunset:
 - Will consider continued existence of the TDI
 - Will consider continued existence of OPIC
 - TLTA and STG will be vigilant to maintain the basic powers of the Commissioner as is and the existence of regulations
 - GAO, NAIC and Texas are all beginning to appreciate the Texas system.
 - It may be imperfect and frustrating but it seems to work.

Rules Hearing

- The rule hearing should be held in the fall.
- STG and TLTA have filed numerous agenda items.

STG Matters

- Leasehold endorsement:
 - Would adopt new ALTA form, Texanized for use with T-1.
 - Would adopt new ALTA form, Texanized for use with T-2.
- Future Advances/ Revolving Credit endorsement
 - Adopts ALTA 14-06, Texanized for use with T-2.

STG Matters

- Non-imputation (mezzanine financing) T-24.1
 - This endorsement is used in the most complex financing situations on commercial deals only
 - A hybrid of debt and equity financing that is typically used to finance the expansion of existing companies. Mezzanine financing is basically debt capital that gives the lender the rights to convert to an ownership or equity interest in the company if the loan is not paid back in time and in full. It is generally subordinated to debt provided by senior lenders such as banks and venture capital companies.

Since mezzanine financing is usually provided to the borrower very quickly with little due diligence on the part of the lender and little or no collateral on the part of the borrower, this type of financing is aggressively priced with the lender seeking a return in the 20-30% range.

Mezzanine financing is advantageous because it is treated like equity on a company's balance sheet and may make it easier to obtain standard bank financing. To attract mezzanine financing, a company usually must demonstrate a track record in the industry with an established reputation and product, a history of profitability and a viable expansion plan for the business (e.g. expansions, acquisitions, IPO)

STG Matters

- P-55 Non-imputation endorsement (T-1)
- Used primarily in mezzanine financing and corresponds to ALTA 16-06.
 - Premium suggested at 5% or \$25

STG Matters

- Co-insurance endorsement T-48.
- Revised the existing co-insurance endorsement to comply with ALTA 23-06 and follow language of new T-1 and T-2.

STG Matters

- Last Dollar endorsement T-15.
- STG recommends deletion of the T-15 as the language to which it applies does not appear in the new T-2 Loan policy and is now inapplicable.

STG Matters

- Revise the ICL T-50
 - Lender– revise to use the ALTA form ICL
- Revise administrative rules to allow cancellation of agent for cause in less than the 30 days currently in the rule.

STG Matters

- Amendment of arbitration language in the owner coverage statement
 - Conforms the statement to the language of the new ALTA style forms and the rule P-36 on deleting this language.

STG Matters

- Pleading to create a new procedural rule that allows agents to agree to provide title information for a set fee and be paid regardless of whether the transaction closes.
 - Will close a loophole TDI audit staff has been using calling such fees cancellation fees.
 - Places the burden for risk of loss with the closing agent since the evidence producing agent has fully performed.

STG Matters

- Pleading to add a new procedural rule prohibiting an agent or insurer from issuing an ICL for the benefit of a non-agent or non-escrow officers.
 - Will clarify that the person "closing the transaction" need not handle the escrow funds to be paid a % of premium
 - Prohibits a company from receipting funds in its name, giving an ICL and then transferring the funds to a P-22 attorney
 - Prohibits the practice of placing the name of a P-22 attorney as co-issuer of the ICL.

TLTA Matters

- T-47 survey affidavit
 - 6. We understand that we have no liability to Title Company or the title insurance company that will issue the policy(ies) should the information in this Affidavit be incorrect other than information that we personally know to be incorrect and which we do not disclose to the Title Company.
 - Underlined words deleted as redundant to definition of Title Company.

TLTA Matters

- Amend P-17 to allow pass thru to consumers of charges to 3rd party vendors of electronic recording charges
- Amend Forms T-1R, T-2R and T-13 to change the names of the forms to agree with the names used for the T-1 and T-2 adopted in 2008, to read as follows:
 - Form T-1R: TEXAS RESIDENTIAL OWNER OWNER'S POLICY OF TITLE INSURANCE – ONE-TO-FOUR FAMILY RESIDENCES
 - Form T-2R: TEXAS SHORT FORM RESIDENTIAL MORTGAGEE LOAN POLICY OF TITLE INSURANCE
 - Form T-13: MORTGAGEE LOAN TITLE POLICY BINDER ON INTERIM CONSTRUCTION LOAN

TLTA Matters

- Item 3 of Schedule B is hereby amended to add the following: “Company insures that standby fees, taxes and assessments by any taxing authority for the year _____ are not yet due and payable.”
 - Inserts omitted word underlined

TLTA Matters

- To correct typographical errors in the Assignment of Rents/Leases Endorsement adopted in 2005, when compared with the CLTA 104.6.
- In paragraph (a) the promulgated form does not contain a blank for the description of the document covered by the endorsement. In paragraph (b) the words “there under” should be a single word “thereunder”.

TLTA Matters

- **P-____. Texas Limited Coverage Residential Chain of Title Policy.**
- a. The Texas Limited Coverage Residential Chain of Title Policy (T-____) may be issued upon request and upon payment of the premium set out in Rate Rule R-____, provided that:
 1. The land is residential real property; and
 2. The proposed insured is an entity which is an institutional lender (such as a bank, savings and loan association, savings bank, or credit union), including a Bank, Credit Union, or Savings Association as defined in § 341.001, Texas Finance Code, or a Mortgage Banker as defined in § 157.002, Texas Finance Code, or an Insurer as defined in § 823.002, Texas Insurance Code.
- b. A Texas Limited Coverage Residential Chain of Title Policy may be issued only by an agent licensed in the county in which the land is located; and no other party may receive any portion of the premium, other than the promulgated division of premium between agent and underwriter.
- c. The Texas Limited Coverage Residential Chain of Policy (T-____) shall not be issued with respect to deeds and leases recorded in the public records more than sixty (60) months immediately preceding the Date of Policy.
- **Justification**
- The residential lending industry has expressed a need for a policy of this type in connection with their ongoing campaign to fight residential mortgage fraud. The policy should only be issued by the agent in the county where the property is located, in order to facilitate a reasonable cost for the policy.

TLTA Matters

- Another combination Agenda Item dealing with minimum escrow audit standards: provides that actual charges for tax search services can be treated the same as actual charges for tax certificates.
- It also provides for some written evidence of the payoff of a loan where there is evidence of a prior lien in the file such as a check or a wire transfer confirmation.
- It further provides that actual charges for a notary service to sign up a party to the transaction may be passed through if there is a written request signed by the consumer requesting an absentee sign up as an accommodation to the requester.

TLTA Matters

- Agenda Item 2006-30, adopted as of May 1, 2008, amended the Deletion of Arbitration Provision to increase the amount of insurance threshold to \$2,000,000. This amendment to the same provision language in the Form T-7 Commitment for Title Insurance will conform the Commitment to the Procedural Rule language.

TLTA Matters

- This policy incorporates by reference those endorsements selected below:
- T-5 (Leasehold Mortgage Policy Endorsement)
- T-17 (Planned Unit Development) The following subparagraphs of this endorsement are deleted: _____
- T-19 (Restrictions, Encroachments, Minerals) [out: The following subparagraph(s) of this endorsement are deleted: _____]
- T-28 (Condominium) [out: The following subparagraph(s) of this endorsement are deleted: _____]
- T-30 (Tax Deletion)
- T-31 (Manufactured Housing) referring to manufactured housing unit serial number
- T-31.1 (Supplemental Coverage Manufactured Housing Unit)
- T-33 (Variable Rate)
- T-33.1 (Variable Rate--Negative Amortization)
- T-35 (Revolving Credit/Future Advance)
- T-36 (Environmental Protection Lien) Paragraph b refers to the following state statute(s): _____
- T-39 (Balloon Mortgage)
- T-42 (Equity Loan Mortgage) and subparagraph 2 (f) of the Equity Loan Mortgage Endorsement set forth in Procedural Rule P-44.C(2) _____ is not added [out: The following subparagraph(s) of this endorsement are deleted: _____]
- T-42.1 (Supplemental Coverage Equity Loan Mortgage) [out: The following subparagraph(s) of this endorsement are deleted: _____]
- T-43 (Texas Reverse Mortgage) [out: The following subparagraph(s) of this endorsement are deleted: _____]
- Section 13 of the Conditions of this policy, which relates to Arbitration, is hereby deleted.

TLTA Matters

- An agenda item amends the name of all of the forms to the new Owner's /Loan on Schedule A.
 - Done for clarity
- Another agenda item : The residential lending industry has expressed a need for a limited search (60 months) policy in connection with their ongoing campaign to fight residential mortgage fraud.

Thank you!

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- Attorneys email bar card number to Ken for CLE credit
- Next Texas TIPS Online August 21, 2008, "Dealing with Churches" by Richard Black
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