

## Insured Closing Letters: What Attorneys Need to Know



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# **Insured Closing Letters: What Attorneys Need to Know**

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## **Presenter**

**MARK D. EPSTEIN** is an attorney with the law firm of Wendel, Rosen, Black & Dean LLP, where his areas of practice focus on real estate and title insurance litigation. Mr. Epstein has represented the firm's title insurance company clients and their insureds (including homeowners, mortgage lenders and construction lenders) in a wide variety of disputes throughout California. Some of the disputes include title and escrow related claims, priority disputes between competing lien holders, easement and encroachment disputes, mechanic's lien and stop notice litigation, wrongful foreclosure, title insurance policy coverage and extra-contractual ("bad faith") litigation. In addition, Mr. Epstein has substantial litigation experience in representing companies that own, lease, manage or operate wireless communications transmission facilities involving a variety of underlying disputes. He earned his B.A. degree from the University of California at Davis and his J.D. degree from the University of San Francisco School of Law.

## **Insured Closing Letters: What Attorneys Need to Know**

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### **I. Requirements in Insured Closing Letter (“ICL”) Coverage**

Separate from policies of title insurance, title insurers will sometimes issue insured closing letters to lenders who are parties to escrow transactions involving the purchase and sale or refinancing of real estate. Insured closing letters are also commonly referred to closing protection letters in some states. The terms “insured closing letter” and “closing protection letter” will be used interchangeably in these materials.

Title agents are customarily authorized, through agency agreements, to sell policies for one or more title insurance underwriters. These agency agreements frequently provide that the agent is an agent solely for the purpose of issuing title insurance commitments and policies, and that the agent is not the title underwriter’s agent for the purpose of conducting settlements or performing escrow services. A lender who also wants the title insurer to be responsible for the agent’s acts in connection with handling its loan funds through escrow closing activities must separately contract with the title insurer for such additional protection by entering into an insured closing letter.

Insured closing letters are *not* policies of title insurance, and they are generally not issued to buyers or sellers of real property. Lenders must separately purchase policies of title insurance to insure the priority of their mortgage liens on the property that serves as collateral for a loan. Indeed, the distinction between insured closing letters and title insurance policies is significant enough that in a number of states, including New York, the insurance commissioners have expressly decided that insured closing letters do not

constitute title insurance and have issued opinions stating that insured closing letters may not even be issued by title companies.

Title insurers often issue insured closing letters as an inducement to lenders to use the insurer's escrow agents to fund and purchase title insurance for their loans. Without an insured closing letter, a title insurer has no liability under the title policy for a loss the lender might sustain as a result of the escrow agent's mishandling of the loan funds. The letters are typically transaction-specific. *Clients Security Fund of the Bar of N.J. v. Security Title and Guar. Co.*, 607 A.2d 1319, 1321-22; *Lawyers Title Ins. Co. v. Edmar Constr. Co.*, 294 A.2d 865 (D.C. 1972); *Fidelity Nat. Title Ins. Co. v. Mussman* 930 N.E.2d 1160 (Ind. 2010) (Fidelity's authority to audit the escrow holder's escrow accounts did not change the escrow holder's limited scope of agency to issue title insurance commitments and policies into a broader general agency in which Fidelity had vicarious liability for misappropriation of loan funds).

## **II. Errors Covered by an Insured Closing Letter – What Triggers a Claim**

Basically, an Insured Closing Agreement is a contract between the title company and the lender whereby the title company agrees to indemnify the lender for certain losses caused by the failure of the issuing agent or approved attorney to follow the closing instructions of the insured or for fraud or dishonesty of the issuing agent or approved attorney.

Unlike title insurance policies, which cover owners for as long as they own the property and cover lenders for the life of the loan, the coverage afforded by an insured closing letter is short lived. Moreover, an insured closing letter only serves to indemnify a lender (not an owner) against loss as a result of fraud, dishonesty, or negligence on the part of the escrow agent in handling any loan funds that are held in the escrow. The letter also provides indemnity coverage to the lender for loss resulting from the escrow agent's failure to comply with the lender's written escrow instructions. *See Lawyers Title Ins.*

*Corp. v. Dearborn Title Corp.*, 993 F.Supp. 1159, 1160 (N.D. Ill. 1998). The protection that is afforded by an insured closing letter typically becomes effective when the addressee signs and returns the letter to the carrier.

The title company will generally require that either the lender's closing instructions require that the title insurance be provided by that title company, or that the lender be furnished a commitment prior to closing. Another requirement is that the loan be closed by an attorney who is on the company's list of approved attorneys.

Some sample insured closing letters are attached to these materials as Exhibits 1 through 3.

Insured closing letters specifically apply to escrow closing activities and services performed for title insurance underwriters, by approved agents or in many states attorneys who are not employees of the title companies. As stated in most insured closing letters, an "Issuing Agent" is defined as an agent authorized to issue title insurance for the title insurance company. Similarly, an "Approved Attorney" is defined as an attorney upon whose certification of title the title insurance company issues title insurance.

These letters are standardized indemnity agreements given to individually named lenders and recite the specific conditions under, and the extent to which, title insurers will accept liability for the acts or omissions of such parties.

An insured closing letter generally applies only with respect to the particular transaction for which it is issued, although, title insurers usually issue a general or "blanket" insured closing letter that protects a particular lender in connection with escrow closing activities and services involving a designated agent for a specified period of time. The insured closing letter specifically provides that the title insurance company will

reimburse the customer named in the letter, when the customer is purchasing the title company's policy, for losses incurred under certain conditions and as the result of certain actions or inactions by the approved agent or attorney. The insured closing letter further provides that the customer's recourse against the title insurer is limited to and defined by the provisions of the letter with respect to such losses.

Insured closing letters are intended to indemnify lenders solely against losses incurred as the result of:

(1) fraud, dishonesty, or negligence by the Issuing Agent or Approved Attorney in handling the lender's funds or documents in connection with the specific transaction, as it relates to the status of the title to the interest in the land being insured or to the validity, enforceability, and priority of the lien of the mortgage on that interest in land; and

(2) failure of the Issuing Agent or Approved Attorney to comply with the written closing instructions of the lender to the extent they relate to status of title to the lender's interest in the land or the validity, priority, or enforceability of the mortgage on the land, including the obtaining of documents and disbursement of funds in connection therewith (although not to the extent such instructions require a determination of the validity, enforceability, or effectiveness of any such document).

Insured closing letters *do not*, however, provide coverage for such matters as failure of the documents to comply with applicable laws or regulations (including environmental, land use, lender regulation, and zoning) or facts and circumstances regarding the closing or the parties to the closing.

The protection afforded by the insured closing agreement will extend to the borrower if the letter is addressed to a lender, if the loan is secured by a one to four family dwelling. The coverage does not extend to losses resulting from a failure to

follow closing instructions where the closing instructions require protection inconsistent with that set out in the title commitment. The fact that closing instructions may require removal of specific exceptions in the commitment is not considered to be a provision inconsistent with the commitment.

The coverage does not cover losses due to bank failure, unless the loss is caused by the failure of the attorney to deposit the funds in the bank named in the closing instructions. Mechanics' and materialmen's liens are not covered by the insured closing agreement. Protection against such liens is as provided by the commitment and policy. Prior to closing, the lender will have to make two determinations. First, that they have an insured closing agreement with the title company and second, that the closing attorney is an approved attorney of the title company.

The lender will call the title company and ask for the insured closing letter. The title company will issue an insured closing agreement when first contacted by the lender. The agreement sets forth the provisions of the insured closing service. The agreement will state that closings conducted by one of the company's approved attorneys will be covered by the insured closing agreement, and will state that the closing attorney is one of the company's approved attorneys. If an insured closing agreement has already been issued, the company will send an insured closing letter to verify that the closing attorney is an approved attorney and that closings conducted by him will be covered by the insured closing agreement.

Some title companies will send out a letter with each inquiry or request which fully state the terms and provisions of the insured closing agreement. Some lenders will also ask for verification that the attorney is an agent and authorized to issue commitments and policies for the company.

The most important aspect of the insured closing agreement is that it obligates the title company to reimburse for covered losses once the loan or purchase is closed, or, from the lender's point of view, once the funds have been disbursed to the closing attorney. This is true regardless of whether all the requirements of the binder have been complied with by the closing attorney.

Even though all the required affidavits, quit claim deeds, releases, or satisfactions have not been obtained, or even though the attorney may not have made all the payoffs, the title company is obligated under the insured closing agreement. The practical effect, since the closing instructions will require that the closing not occur unless the title policy can be issued, is that at that point the company is obligated to issue the policy as proposed in the commitment, or as required in the closing instructions if the insured closing agreement does not require a commitment to have been issued. Title companies often receive calls from lenders after loans have closed without full compliance with the closing instructions.

The lender may not be able to get the security deed, or a corrective security deed, or some other document required by the closing instructions, such as the title policy. The lender will sometimes state that they will make a claim under the Insured Closing Agreement if the attorney does not comply with the requirements. The title company will then contact the attorney to try to get the matter resolved.

### **III. What Stops Insured Cover Letter Coverage**

Insured closing letters frequently by their terms provide very short lived coverage, such as a 90-day period from the date of the insured's discovery of the loss to provide written notice of a claim to the insurer. Moreover, many insured closing letters go on to state that in any event the insurer "shall not be liable hereunder unless notice of claim in writing is received by the Company within one year from the date of closing."

According to the terms of many insured closing letters, the insurers have no liability for any claims there under unless they receive notice of the claim within ninety (90) days from the date of the discovery of loss, and the company receives written notice of the claim in any event no later than one year from the date of closing, period. Thus, insured closing letter claims must be submitted promptly, or else the lender risk losing any potential coverage that may otherwise be afforded by the insured closing letter.

#### **IV. Processes to Safeguard Your Client**

Insured closing letters serve to extend the liability of creditworthy title insurance companies, the scope of which would otherwise be limited to the title insurance policy's coverage for errors in the property's title, or the validity or priority of the lien of the insured mortgage. Insured closing letters expand the protections afforded to the lender to cover certain "bad acts" of the company's "Issuing Agent" or "Approved Attorney".

However, the additional protection of an insured closing letter must be separately and specifically requested from the title insurer prior to the lender's funding of the loan proceeds into escrow. Moreover, the scope of the coverage afforded by the insured closing letter is limited and is defined solely by the terms and provisions of the letter.

Coverage under the insured closing letter is also strictly limited to the named parties designated therein, and generally applies only with respect to the particular transaction for which the letter is furnished, unlike a lender's policy of title insurance which usually provides coverage for any successor(s) in interest to whom the lender may sell the loan. Therefore, it is important for both the insured lender and their counsel to understand the nature and scope of protection that is afforded by insured closing letters, as well as the agency relationships that exist between title insurance companies and their issuing agents or approved attorneys.

# **EXHIBIT 1**

**SAMPLE INSURED CLOSING LETTER –  
SINGLE TRANSACTION LIMITED LIABILITY**

[DATE]

NAME OF TITLE INSURANCE COMPANY

Name and Address of Addressee (covered lender):

Name of Issuing Agent or Approved Attorney (hereafter, “Issuing Agent” or “Approved Attorney”, as the case may require):

*[Identity of settlement agent and status as either Issuing Agent or Approved Attorney appears here.]*

Transaction (hereafter, “the Real Estate Transaction”):

Re: Closing Protection Letter

Dear \_\_\_\_\_:

[ \_\_\_\_\_ ] Title Insurance Company (the “Company”) agrees, subject to the Conditions and Exclusions set forth below, to reimburse you for actual loss incurred by you in connection with the closing of the Real Estate Transaction conducted by the Issuing Agent or Approved Attorney, provided:

(A) title insurance of the Company is specified for your protection in connection with the closing of the Real Estate Transaction;

(B) you are to be the (i) lender secured by a mortgage (including any other security instrument) of an interest in land, its assignees or a warehouse lender, (ii) purchaser of an interest in land, or (iii) lessee of an interest in land; and

(C) the aggregate of all funds you transmit to the Issuing Agent or Approved Attorney for the Real Estate Transaction does not exceed \$ \_\_\_\_\_ and provided the loss arises out of:

1. Failure of the Issuing Agent or Approved Attorney to comply with your written closing instructions to the extent that they relate to (a) the status of the title to that interest in land or the validity, enforceability and priority of the lien of the mortgage on that interest in land, including the obtaining of documents and the disbursement of funds necessary to establish the status of title or lien, or (b) the obtaining of any other document, specifically required by you, but only to the extent the failure to obtain the other document affects the status of the title to that interest in land or the validity, enforceability and priority of the lien of the mortgage on that interest in land, and not to the extent that your instructions require a determination of the validity, enforceability or the effectiveness of the other document, or

2. Fraud, dishonesty or negligence of the Issuing Agent or Approved Attorney in handling your funds or documents in connection with the closing to the extent that fraud, dishonesty or negligence relates to the status of the title to that interest in land or to the validity, enforceability, and priority of the lien of the mortgage on that interest in land.

If you are a lender protected under the foregoing paragraph, your borrower, your assignee and your warehouse lender in connection with a loan secured by a mortgage shall be protected as if this letter were addressed to them.

#### Conditions and Exclusions

1. The Company will not be liable to you for loss arising out of:

A. Failure of the Issuing Agent or Approved Attorney to comply with your closing instructions which require title insurance protection inconsistent with that set forth in the title insurance binder or commitment issued by the Company. Instructions which require the removal of specific exceptions to title or compliance with the

requirements contained in the binder or commitment shall not be deemed to be inconsistent.

B. Loss or impairment of your funds in the course of collection or while on deposit with a bank due to bank failure, Insolvency or suspension, except as shall result from failure of the Issuing Agent or Approved Attorney to comply with your written closing instructions to deposit the funds in a bank which you designated by name.

C. Defects, liens, encumbrances or other matters in connection with the Real Estate Transaction if it is a purchase, lease or loan transaction except to the extent that protection against those defects, liens, encumbrances or other matters is afforded by a policy of title insurance not inconsistent with your closing instructions.

D. Fraud, dishonesty or negligence of your employee, agent, attorney or broker.

E. Your settlement or release of any claim without the written consent of the Company.

F. Any matters created, suffered, assumed or agreed to by you or known to you.

2. If the closing is conducted by an Approved Attorney, a title insurance binder or commitment for the issuance of a policy of title insurance of the Company must have been received by you prior to the transmission of your final closing instructions to the Approved Attorney.

3. When the Company shall have reimbursed you pursuant to this letter, it shall be subrogated to all rights and remedies which you would have had against any

person or property had you not been so reimbursed. Liability of the Company for such reimbursement shall be reduced to the extent that you have knowingly and voluntarily impaired the value of this right of subrogation.

4. The Issuing Agent is the Company's agent only for the limited purpose of issuing title insurance policies. Neither the Issuing Agent nor the Approved Attorney is the Company's agent for the purpose of providing other closing or settlement services. The Company's liability for your losses arising from those other closing or settlement services is strictly limited to the protection expressly provided in this letter. Any liability of the Company for loss does not include liability for loss resulting from the negligence, fraud or bad faith of any party to a real estate transaction other than an Issuing Agent or Approved Attorney, the lack of creditworthiness of any borrower connected with a real estate transaction, or the failure of any collateral to adequately secure a loan connected with a real estate transaction. However, this letter does not affect the Company's liability with respect to its title insurance binders, commitments or policies.

5. Either the Company or you may demand that any claim arising under this letter be submitted to arbitration pursuant to the Title Insurance Arbitration Rules of the American Land Title Association, unless you have a policy of title insurance for the applicable transaction with an Amount of Insurance greater than \$2,000,000. If you have a policy of title insurance for the applicable transaction with an Amount of Insurance greater than \$2,000,000, a claim arising under this letter may be submitted to arbitration only when agreed to by both the Company and you.

6. You must promptly send written notice of a claim under this letter to the Company at its principal office at \_\_\_\_\_.  
The Company is not liable for a loss if the written notice is not received within one year from the date of the closing.

Any previous closing protection letter or similar agreement is hereby cancelled with respect to the Real Estate Transaction.

**[NAME OF TITLE INSURANCE COMPANY]**

**By:** \_\_\_\_\_

## **EXHIBIT 2**

**SAMPLE CLOSING PROTECTION LETTER [NO. 2]**

[DATE]

To: ABC Lender

Re: Closing Protection Letter  
[Subject Property / Transaction]

Dear ABC Lender,

When title insurance of [Name of Title Insurance Company] (the Company) is specified for your protection in connection with closings of real estate transactions in which you are to be the: (a) lessee of an interest in land, (b) purchaser of an interest in land, or (c) lender secured by a mortgage (including any other security instrument) of an interest in land, its assignees or a warehouse lender, the Company, subject to the Conditions and Exclusions set forth below, hereby agrees to reimburse you for actual loss incurred by you in connection with such closings when conducted by Name of Issuing Agent, Approved Attorney or Approved Closing Vendor (the Issuing Agent) and when such loss arises out of:

A. Failure of the Issuing Agent, to comply with your written closing instructions to the extent that they relate to (a) the status of the title to said interest in land or the validity, enforceability and priority of the lien of said mortgage on said interest in land, including the obtaining of documents and the disbursement of funds necessary to establish such status of title or lien, or (b) the obtaining of any other document specifically required by you, but not to the extent that said instructions require a determination of the validity, enforceability or effectiveness of such other document, or (c) the collection and payment of funds due you, or

B. Fraud, dishonesty or negligence of the Issuing Agent in handling your funds or documents in connection with such closings to the extent such fraud,

dishonesty or negligence relates to the status of the title to said interest in land or to the validity, enforceability, and priority of the lien of said mortgage on said interest in land. If you are a lender protected under the foregoing paragraph, your borrower, your assignee and your warehouse lender in connection with a loan secured by a mortgage shall be protected as if this letter were addressed to them. Conditions and Exclusions

1. The Company will not be liable to you for loss arising out of:

A. Failure of the Issuing Agent to comply with your closing instructions which require title insurance protection inconsistent with that set forth in the title insurance binder or commitment issued by the Company. Instructions which require the removal of specific exceptions to title or compliance with the requirements contained in said binder or commitment shall not be deemed to be inconsistent.

B. Loss or impairment of your funds in the course of collection or while on deposit with a bank due to bank failure, insolvency or suspension, except such shall result from failure of the Issuing Agent, to comply with your written closing instructions to deposit the funds in a bank which you designated by name.

C. Mechanics' and materialmen's liens in connection with your purchase or lease or construction loan transactions, except to the extent that protection against such liens is afforded by a title insurance binder, commitment or policy of the Company.

D. Fraud, dishonesty or negligence of your employee, agent, attorney or broker.

E. Your settlement or release of any claim without the written consent of the

Company.

F. Any matters created, suffered, assumed or agreed to by you or known to you.

2. If the closing is to be conducted by an Approved Attorney or Approved Closing Vendor, a title insurance binder or commitment for the issuance of a policy of title insurance of the Company must have been received by you prior to the transmission of your final closing instructions to the Approved Attorney or Approved Closing Vendor.

3. When the Company shall have reimbursed you pursuant to this letter, it shall be subrogated to all rights and remedies which you would have had against any person or property had you not been so reimbursed; Liability of the Company for such reimbursement shall be reduced to the extent that you have knowingly and voluntarily impaired the value of such right of subrogation.

4. The protection herein offered shall not extend to any transaction in which the funds you transmit to the Issuing Agent, Approved Attorney or Approved Closing Vendor exceed five million dollars \$5,000,000.00. The Company shall have no liability of any kind for the actions or omissions of the Issuing Agent, Approved Attorney or Approved Closing Vendor in such a transaction except as may be derived under the Company's commitment for title insurance, policy of title insurance or other express written agreement. Please contact the Company if you have such a transaction and desire the protections of this letter to apply to it. This paragraph shall not apply to individual mortgage loan transactions on individual one-to-four-family residential properties (including residential townhouse, condominium and cooperative apartment units).

5. Any liability of the Company for loss incurred by you in connection with closings of real estate transactions by an Issuing Agent, Approved Attorney or Approved Closing Vendor shall be limited to the protection provided by this letter. However, this

letter shall not affect the protection afforded by a title insurance binder, commitment or policy of the Company.

6. Claim shall be made promptly to the Company at its principal office at Address of Title insurance Company. When the failure to give prompt notice shall prejudice the Company, then liability of the Company hereunder shall be reduced to the extent of such prejudice.

7. The protection herein offered extends only to real property transactions in the state(s) of Name of State.

Any previous insured closing service letter or similar agreement is hereby canceled except as to closings of your real estate transactions regarding which you have previously sent or within 30 days hereafter send written closing instructions to the Issuing Agent, Approved Attorney or Approved Closing Vendor.

[NAME OF TITLE INSURANCE COMPANY]

By: \_\_\_\_\_

## **EXHIBIT 3**

BLANK TITLE INSURANCE COMPANY

[DATE]

Name and Address of Addressee:

RE: Closing Protection Letter

Dear \_\_\_\_\_:

When title insurance of Blank Title Insurance Company is specified for your protection in connection with closings of [Specify State] real estate transactions in which you are to be the lessee or purchaser of an interest in land or a lender secured by a mortgage (including any other security instrument) of an interest in land, the Company, subject to the Conditions and exclusions set forth below, hereby agrees to reimburse you for actual loss incurred by you in connection with such closings when conducted by an Issuing Agent (an agent authorized to issue title insurance for the Company) or an Approved Attorney (an attorney upon whose certification of title the Company issues title insurance) and when such loss arises out of:

1. Failure of the Issuing Agent or Approved Attorney to comply with your written closing instructions to the extent that they relate to (a) the status of the title to said interest in land or the validity, enforceability and priority of the lien of said mortgage on said interest in land, including the obtaining of documents and the disbursements of funds necessary to establish such status of title or lien, or (b) the obtaining of any other document, specifically required by you, but only to the extent the failure to obtain such other document affects the status of the title to said interest in land or the validity, enforceability and priority of the lien of said mortgage on said interest in land, or

2. Fraud or dishonesty of the Issuing Agent of Approved Attorney in handling your funds or documents in connection with such closings to the extent such fraud or dishonesty relates to the status of the title to said interest in land or to the validity, enforceability, and priority of the lien of said mortgage on said interest in land. If you are a lender protected under the foregoing paragraph, your borrower in connection with a loan secured by a mortgage on a one-to-four family dwelling shall be protected as if this letter were addressed to your borrower.

### Conditions and Exclusions

A. The Company will not be liable to you for loss arising out of:

1. Failure of the Approved Attorney to comply with your closing instructions which require title insurance protection inconsistent with that set forth in the title insurance binder or commitment issued by the Company. Instructions which require the removal of specific exceptions to title or compliance with the requirements contained in said binder or commitment shall not be deemed to be inconsistent.

2. Loss or impairment of your funds in the course of collection or while on deposit with a bank due to bank failure, insolvency or suspension, except such as shall result from failure of the Issuing Agent or the Approved Attorney to comply with your written closing instructions to deposit the funds in a bank which you designated by name.

3. Mechanics' and materialmen's liens in connection with your purchase or lease or construction loan transactions, except to the extent that protection against such liens is afforded by a title insurance binder, commitment or policy of the Company.

4. Failure of the Issuing Agent or Approved Attorney to comply with your written closing instructions to the extent such instructions require a determination by the Issuing Agent or Approved Attorney of the validity, enforceability or effectiveness of any document contemplated under paragraph 1(b) above.

B. When the Company shall have reimbursed you pursuant to this letter, it shall be subrogated to all rights and remedies which you would have had against any person or property had you not been so reimbursed. Liability of the Company for such reimbursement shall be reduced to the extent that you have knowingly and voluntarily impaired the value of such right of subrogation.

C. Any liability of the Company for loss incurred by you in connection with closings of real estate transactions by an Issuing Agent or Approved Attorney shall be limited to the protection provided by this letter. However, this letter shall not affect the protection afforded by a title insurance binder, commitment or policy of the Company.

D. Claims shall be made promptly to the Company at its principal office at \_\_\_\_\_. When the failure to give prompt notice shall prejudice the Company, then liability of the Company hereunder shall be reduced to the extent of such prejudice.

E. The protection herein offered extends only to real property transactions in (Specify State). The protection herein offered will be effective upon receipt by the Company of your acceptance in writing, which may be made on the enclosed copy hereof and will continue until canceled by written notice from the Company.

Any previous Insured Closing Service letter or similar agreement is hereby canceled, except as to closings of your real estate transactions regarding which you have previously sent (or within 30 days hereafter send) written closing instructions to the Issuing Agent or Approved Attorney.

NAME OF TITLE INSURANCE COMPANY

By: \_\_\_\_\_

(Title)

Accepted: (Date)

\_\_\_\_\_

By: \_\_\_\_\_

(Title)

(The name of a particular issuing agent)

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