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Opinion No. 06-014

Residential Closing Funds Distribution Act of 2005

QUESTIONS

1. Under 2005 Tenn. Pub. Acts Ch. 273, now codified at Tenn. Code Ann.§§ 47-32-101, *et seq.*, the "Good Funds Act," mortgage lenders and settlement agents are required to disburse loan funds in one of several forms specified in the statute.

a. Under Tenn. Code Ann. § 47-32-102(2)(E), one of the forms is a "teller's check or other official check, however designated,"that is "drawn on or payable through a financial institution within the same Federal Reserve check processing region as the location of the settlement agent." Does a teller's check issued by a financial institution with a branch within the same Federal Reserve region meet this requirement?

b. Under Tenn. Code Ann. § 47-32-102(2)(B), another form is "wired funds." Would this term include funds delivered by all forms of "electronic delivery"?

c. Under Tenn. Code Ann. § 47-32-102(2)(A), another form is "cash." Would a deposit, that is, a transfer, by a bank into the account of a settlement agent in its bank be "cash" under this provision?

2. Under Tenn. Code Ann. § 47-32-107(a), a party violating the act is liable to any other party for actual damages and reasonable attorneys' fees. The statute provides that, "[i]n addition, any party in violation of this chapter shall pay to the other party or parties suffering a loss an amount equal to one thousand dollars ($1,000) or double the amount of interest payable on the mortgage loan for the first sixty (60) days after the loan closing, whichever amount is greater." Is this one thousand dollar payment only available to parties that otherwise suffer a loss due to the fault of the parties causing the loss?

OPINIONS

1. a. No. We think a court would conclude that, in order to meet the requirement of the Good Funds Act, a teller's check must be issued by a financial institution and either drawn on or payable through a bank assigned a number in the same Federal Reserve check processing region as the location of the settlement agent.

b. We think a court would conclude that the term "wired funds" includes an ACH credit transfer or any transfer that meets the definition of "wire transfer" under 12 C.F.R. § 229.2(ll).

c. Assuming the transfer is made on the bank's books, we think a court would conclude that a transfer by a bank into the account of a settlement agent in the same bank would meet the definition of "wire transfer" under Reg CC and, therefore, qualify as "wired funds" under the Good Funds Act. Assuming the funds are immediately available for withdrawal, it could also be argued that the transfer is "cash" under the Good Funds Act.

2. We think a court would conclude that, in order to be entitled to this payment, a party must have actually suffered a loss as a result of the violation. But the Good Funds Act imposes liability on any party or party that violates the act, regardless of whether that party was at fault.

ANALYSIS

This opinion addresses several questions about 2005 Tenn. Pub. Acts Ch. 273, now codified at Tenn. Code Ann. §§ 47-32-101, *et seq*., the "Good Funds Act." Our Office has received material from the Tennessee Bankers Association, the Tennessee Land Title Association, and the Tennessee Bar Association expressing concerns about the correct interpretation of this act. The Good Funds Act requires mortgage loans on certain residential real property and agricultural property to be funded at closing with funds in one of seven different forms. Under Tenn. Code Ann. § 47-32-104(a):

> A mortgage lender, mortgage loan broker, mortgage loan servicer, or other person shall, at or before loan closing, cause disbursement of loan funds, in one (1) of the forms identified in § 47-32-102(2), to the settlement agent.

"Mortgage lender" means:

> any person who, in the regular course of business, lends money that is secured by a mortgage or deed of trust on real estate. "Mortgage lender" includes a "mortgage loan broker" and "mortgage loan servicer."

Tenn. Code Ann. § 47-32-102(10).

"Mortgage" means a "mortgage" or "deed of trust" as defined in and allowed pursuant to § 66-5-103. Tenn. Code Ann. § 47-32-102(9). "Mortgage loan broker" is defined as:

> any person who, for compensation or other gain, paid directly or indirectly, or in expectation of compensation or other gain, solicits, processes, places, negotiates or originates mortgage loans for others, or offers to solicit, process, place, negotiate or originate mortgage

> loans for others, or who close mortgage loans that may be in the mortgage loan broker's own name with funds provided by others and which loans are thereafter assigned to the person providing the funding of such loans; regardless of whether the acts are done directly or indirectly, through contact by telephone, by electric means, by mail, or in person with the borrowers or potential borrowers.

Tenn. Code Ann. § 47-32-102(12). A "mortgage loan servicer" means "any person who, in the regular course of business, assumes responsibility for servicing and accepting payments for a mortgage loan." Tenn. Code Ann. § 47-32-102(13). "Loan closing" means "that time agreed upon by the borrower and lender, when the execution of the loan documents by the borrower occurs." Tenn. Code Ann. § 47-32-102(6).

The Good Funds Act also imposes responsibilities on settlement agents. A "settlement agent" is:

> the person, other than a mortgage lender, responsible for conducting the settlement and disbursement of the settlement proceeds, and includes any individual, corporation, partnership, or other entity conducting the settlement, collection and disbursement of loan proceeds.

Tenn. Code Ann. § 47-32-102(15).

"Settlement" means:

> the time when the settlement agent has received the duly executed deed, loan funds, loan documents, and other documents and funds required to carry out the terms of the contract between the parties, and the settlement agent reasonably determines that prerecordation conditions of such contracts have been satisfied. "Parties" as used in this subdivision (14) means the seller, purchaser, borrower, lender and the settlement agent.

Tenn. Code Ann. § 47-32-102(14).

Tenn. Code Ann. § 47-32-105 provides in relevant part:

> (a) No settlement agent shall disburse any funds from an escrow or settlement account in connection with a mortgage loan transaction identified in § 47-32-103(a), until:

> (1) Disbursement of loan funds, designated for said mortgage loan, has been received by the settlement agent;
>
> (2) Such additional funds necessary to be provided by the borrower or other third party to fully fund the transaction have been received. All additional funds required by this subdivision (a)(2) in excess of one thousand dollars ($1,000), shall be provided to the settlement agent in one (1) of the forms identified in § 47-32-102(2); and
>
> (3) All documents required to complete the transaction have been executed and are deemed suitable for recording.

Tenn. Code Ann. § 47-32-105(a). "Disbursement of loan funds" means the delivery of loan funds by the mortgage lender to the settlement agent in one or more of seven different forms. Tenn. Code Ann. § 47-32-102(2). Delivery of funds in one of these forms is the key portion of the act. The act provides:

> "Disbursement of loan funds" means the delivery of the loan funds by the mortgage lender to the settlement agent ***in one (1) or more of the following forms:***
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> (A) Cash;
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> (B) Wired funds;
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> (C) Checks issued by the state of Tennessee or a political subdivision of the state;
>
> (D) Cashier's check;
>
> (E) Teller's check or other official check, however designated, that is:
>
> (i) Issued by a financial institution; and
>
> (ii) Drawn on or payable through a financial institution within the same Federal Reserve check processing region as the location of the settlement agent;
>
> (F) Checks issued by an instrumentality of the United States organized and existing under the Farm Credit Act of 1971, compiled in 12 U.S.C. § 2001 *et seq.*; or

> (G) Checks issued from the escrow or trust account of a real estate broker licensed pursuant to the Tennessee Real Estate Broker License Act of 1973, compiled in title 62, chapter 13, and drawn on or payable through a financial institution within the same Federal Reserve check processing region as the location of the settlement agent, in an amount not to exceed the earnest money paid by the purchaser and collected in such fiduciary account.

Tenn. Code Ann. § 47-32-102(2) (emphasis added).

Under Tenn. Code Ann. § 47-32-106, failure to comply does not affect the validity or enforceability of any loan documents. But, under Tenn. Code Ann. § 47-32-107, a party violating the act is liable to any other party suffering a loss due to the violation for certain damages.

The Good Funds Act, therefore, concerns the time at which the purchase of residential property financed by a mortgage loan is actually closed. This typically takes place at an appointed time when the buyer, seller, and other parties execute all the documents and pay out all the funds required to complete the transaction. Under the act, a mortgage lender, broker, or servicer must deliver the mortgage loan funds to purchase the property and pay other transaction charges in one of seven forms at the closing. The settlement agent, a third party responsible for conducting the settlement, may not pay out funds from an escrow or settlement account to the seller or other entities to which fees are due unless the settlement agent has received mortgage loan funds in one of the forms specified in the act.

Senator Ketron, who sponsored the Good Funds Act in the Senate, stated that the bill "eliminates the float because the federal Check 21 act eliminated the float on checking accounts; what this does is eliminates the float from the escrow account at the time of closing on mortgages." Senate Session April 28, 2005 (remarks of Senator Ketron). "Check 21" refers to the Check Clearing for the 21st Century Act passed by Congress in 2003 and now partly codified at 12 U.S.C. § 4001 and § 4002. This act is implemented by federal regulations at 12 C.F.R. §§ 229.1, *et seq.*, generally referred to as "Reg CC."

1. Required Form of Funds

a. Teller's Check

The first question concerns the features that a document or transfer must meet in order to fall within one of the seven required forms. Tenn. Code Ann. § 47-32-102(2)(E) provides that the mortgage lender may satisfy the Good Funds Act by delivery of a "teller's check" or other official check, which meets two requirements: 1) it must be issued by a financial institution; and, 2) it must be drawn on or payable through a financial institution within the same Federal Reserve check processing region as the location of the settlement agent. The Good Funds Act imposes a similar requirement on escrow or trust account checks under Tenn. Code Ann. § 47-32-102(2)(G). The question is whether a teller's check issued by a financial institution with a branch within the same

Federal Reserve region satisfies the Good Funds Act. We think that, under the plain language of the statute, a teller's check must be issued by a financial institution, *and* it must be drawn on or payable through a financial institution assigned a number in the same Federal Reserve check processing region as the location of the settlement agent.

Under the Tennessee Commercial Code, Tenn. Code Ann. §§ 47-1-101, *et seq.*, a check "issued" by a financial institution is not necessarily drawn on or payable through that financial institution. Under Tenn. Code Ann. § 47-3-105(a), "issue" means "the first delivery of an instrument by the maker or drawer, whether to a holder or nonholder, for the purpose of giving rights on the instrument to any person." "Drawer" means a person who signs or is identified in a draft as a person ordering payment. Tenn. Code Ann. § 47-3-103(a)(3). "Maker" means a person who signs or is identified in a note as a person undertaking to pay. Tenn. Code Ann. § 47-3-103(a)(4). Under Tenn. Code Ann. § 47-4-104(a)(8), as applied to bank deposits and collections, "drawee" means a person ordered in a draft to make payment. Under Tenn. Code Ann. § 47-4-106(a):

> If an item states that it is "payable through" a bank identified in the item, (i) the item designates the bank as a collecting bank and does not by itself authorize the bank to pay the item, and (ii) the item may be presented for payment only by or through the bank.

A "collecting bank" is a bank handling an item for collection except the payor bank. Tenn. Code Ann. § 47-4-105(5). The "payor bank" is the bank that is the drawee of a draft. Tenn. Code Ann. § 47-4-105(3). Thus, a teller's check may be drawn on one bank, and payable through another.

The Good Funds Act does not define the term "Federal Reserve check processing region." Reg CC defines "check processing region" as "the geographical area served by an office of a Federal Reserve Bank for purposes of its check processing activities." 12 C.F.R. § 229.2(m). The Board of Governors of the Federal Reserve System also provided commentary to Reg CC as Appendix E to Part 229. The commentary provides background material to explain the Board's intent in adopting a particular part of the regulation. 12 C.F.R. Pt. 229, App. E, I.A.1. With regard to the definition of "check processing region," the commentary provides in part:

> The Board has defined check processing region as the territory served by one of the Federal Reserve head offices, branches, or regional check processing centers. Appendix A includes a list of routing numbers arranged by Federal Reserve Bank office. The definition of check processing region is key to determining whether a check is considered local or nonlocal.

12 C.F.R. Pt. 229, App. E., II.M. The term "check processing region," therefore, is directly tied to the routing number system used by the Federal Reserve to process checks. Based on the language of the Good Funds Act regarding a teller's check, we think a court would conclude that, in order to meet the requirements of the Good Funds Act, a teller's check must be drawn on or payable through a bank whose checks are processed through the same Federal Reserve check processing region as

the location of the settlement agent. As a practical matter, this requirement would be met if the check is drawn on or payable through a bank assigned a number in the same Federal Reserve check processing region as the location of the settlement agent.

Material included with the request points out that an argument can be made that a bank is "located" in the check processing region if it has a branch located in that region. But the statute states that a teller's check must be "drawn on or payable through" a bank located in that region. Further, legislative history of the Good Funds Act reflects that it was enacted in response to federal law changes implemented by Reg CC. We think a court would conclude that, in order to meet the requirements of the Good Funds Act, a teller's check must be drawn on or payable through a bank whose checks are processed within the same check processing region as the settlement agent.

b. "Wired Funds"

The next question concerns which transactions would fall within the category of "wired funds" under the Good Funds Act. The request asks whether the term "wired funds" would include funds delivered by all forms of "electronic delivery." We have found no definition of the term "electronic delivery" in state law. Nor does the Good Funds Act define the term "wired funds." Again, we think a court would look to Reg CC for guidance on the meaning of this term. Under 12 C.F.R. § 229.10(b), a bank must generally make funds received for deposit in an account by an "electronic payment" available for withdrawal on the next business day. Under Reg CC, the term "electronic payment" means a wire transfer or an ACH credit transfer. 12 C.F.R. § 229.2(p). The regulation defines "wire transfer" as follows:

> Wire transfer means an unconditional order to a bank to pay a fixed or determinable amount of money to a beneficiary upon receipt or on a day stated in the order, that is transmitted by electronic or other means through Fedwire, the Clearing House Interbank Payments System, other similar network, between banks, or on the books of a bank. Wire transfer does not include an electronic fund transfer as defined in section 903(6) of the Electronic Fund Transfer Act (15 U.S.C. 1693a(6)).

12 C.F.R. § 229.2(ll). We think a court would conclude that any ACH credit transfer or transfer that falls within this definition would be "wired funds" within the meaning of the Good Funds Act.

c. Transfer by a Bank into the Account of a Settlement Agent in the Same Bank

The next question is whether a transfer by a bank into the account of a settlement agent in the same bank should be "cash" within the requirements of the Good Funds Act. Assuming the transfer is made on the bank's books, we think a court would conclude that a transfer by a bank into the account of a settlement agent in the same bank would meet the definition of "wire transfer" under Reg CC and, therefore, qualify as "wired funds" under the Good Funds Act. Assuming the

funds are immediately available for withdrawal, it could also be argued that the transfer is "cash" under the Good Funds Act.

2. Damages for Violating the Good Funds Act

The next question concerns the availability of damages for a violation of the Good Funds Act. Tenn. Code Ann. § 47-32-106 provides that failure to comply with the act does not affect the validity or enforceability of any loan documents. Tenn. Code Ann. § 47-32-107 provides as follows:

> (a) Any party violating this chapter is liable to any other party *suffering a loss due to such violation, for any actual damages sustained, plus reasonable attorneys' fees*. In addition, any party in violation of this chapter shall pay to the other party or parties *suffering a loss* an amount equal to one thousand dollars ($1,000), or double the amount of interest payable on the mortgage loan for the first sixty (60) days after the loan closing, whichever amount is greater.
>
> (b) Any party may bring an action in chancery court for declaratory or injunctive relief to prevent any violations of this chapter.
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> (c) In any private action commenced under this chapter, upon finding that the action is frivolous, without legal or factual merit, or brought for the purpose of harassment, the court may require the person instituting the action to indemnify the defendant for any damages incurred, including reasonable attorneys' fees and costs.

(Emphasis added). The question is whether the thousand dollar or double sixty days' interest payment is only available to parties that otherwise suffer a loss due to the fault of the parties causing the loss. By its terms, the Good Funds Act imposes liability on a party that violates the act to any party that suffers a loss due to the violation of the act. The measure of damages is actual damages from the loss plus reasonable attorneys' fees. In addition, any party must pay a thousand dollars or double sixty days' interest to the other party or parties "suffering a loss." We think a court would conclude that, in order to be entitled to this payment, a party must have actually suffered a loss as a result of the violation. But the Good Funds Act imposes liability on any party or party that violates the act, regardless of whether that party was at fault.

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