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LOAN DISBURSING SAFEGUARDS

Recent events in St. Louis have demonstrated again how risky loan disbursing can be. Here are three things to remember to help keep your financial institution protected against misappropriation or improper disbursement of loan proceeds by a title company

1. **Updating Title Commitments before Closing.** No loan should be closed until the title commitment is amended to make it effective as of the date the deed of trust is recorded, and to remove all standard exceptions from coverage (survey, parties in possession, mechanics liens), and confirming that the lender is to have a first priority lien. Other modifications to the commitment may also be appropriate, but these are mandatory. These adjustments can be made by writing them on the commitment and having the title company initial, but it is preferable to have a form letter (prepared by the lender) signed by the title company agreeing to the changes. Failure to do this can leave the lender without full insurance coverage if there is a problem with title.
2. **Insured Closing Letter.** Disbursement is done by the local title agency and in the absence of a special agreement the underwriter is not responsible for misappropriation or misapplication of loan proceeds by the agency. Most title agencies do not have enough assets to cover major claims if they misapply loan proceeds. The underwriter may be made responsible for misapplication of loan funds if the underwriter issues an "insured closing letter." This letter can be obtained merely by requesting it from the agency. It can be obtained for each deal, but some underwriters will issue a letter that is good for a period of time so that it is not necessary to get one for each closing. An insured closing letter should be mandatory for each loan where the title company is responsible for disbursing any loan proceeds. Read the letter carefully for any conditions or limitations on its applicability.
3. **Self Disbursing Waiver.** If the lender will be disbursing loan funds for construction, the lender should obtain an agreement from the borrower acknowledging that it is the borrower's primary responsibility to determine when funds should be disbursed and to whom they should be disbursed. Some borrowers have been blaming lenders when loan funds are gone and the work was not completed. The allegation is that the lender should be responsible for proper application of the loan proceeds. The self disbursing waiver makes it clear that the lender is not exercising discretion in making advances and that it is up to the customer to either direct disbursements itself or designate another professional to direct disbursements. The agreement should also waive any liability on the part of the bank for selection of the title company or disbursing agent.

LIMITATIONS ON POWERS OF ATTORNEY

Interpreting powers of attorney is a difficult process. To avoid liability, financial institutions should permit only specially trained employees to decide whether or not to honor a power of attorney. The following are certain things that CANNOT be done by an attorney in fact unless the action is SPECIFICALLY AUTHORIZED in the power of attorney.

1. Sign a guaranty on behalf of the grantor of the power of attorney.
2. Transfer money to an account in the name of the attorney in fact or put the attorney in fact on the account as a joint owner or pay on death beneficiary.
3. Withdrawal of cash by the attorney in fact
4. In Missouri, permitting the attorney in fact to add or remove a joint owner or pay on death beneficiary on any account or to transfer funds into the account of another person.

TAX ID NUMBERS FOR LIMITED LIABILITY COMPANIES

If a limited liability company has only one member, the IRS permits the LLC to use the Social Security number of the member as the LLC's taxpayer identification number. A one-member LLC is a "disregarded entity" for tax purposes. All profits and losses of the LLC are reported directly on the 1040 tax return of the sole member so the LLC, as an entity, is disregarded for tax purposes. Even though the member's Social Security number is used, the account is still opened in the name of the LLC. The use of sole member Social Security numbers for LLC's is becoming more prevalent as LLC's become the preferred business organization. Unfortunately, many account systems do not permit entering a Social Security number as the tax identification number of an entity. Therefore, in order to meet the demand of the customer to use a Social Security number, it may be necessary for the financial institution to make manual entries in IRS reports to override the account computer system.

The contents of this Update are for general information only. Consult your legal counsel before taking actions in reliance on anything contained in this law update. To cancel receipt of the Banking Law Update, send an e-mail and request "Cancel Update".

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