

Escrow Accounts – Follow the Money

“Show me the Money!” is a phrase that became popular in 1996 as the term was often used in conversations between Tom Cruise and Cuba Gooding, Jr. in the 1996 film “Jerry Maguire.” These words also can also be used to confirm proper escrow account procedures are being followed. Seeing the money can reveal both an indiscretion and a legitimate mistake. A title insurance company follows client money to ensure that it is not misplaced or misappropriated. When the money is in the escrow account it is the clients’ money, but if the money goes missing the licensed title insurance agent become responsible for it. The Texas Basic Manual for the Writing of Title Insurance contains Minimum Accounting Procedures and Internal Controls which somewhat mirror the ALTA Best Practice #2. However, BP#2 raises the bar on protection of escrow accounts.

ALTA Best Practice #2

ALTA Best Practice #2 states: *Adopt and maintain appropriate written procedures and controls for Escrow Trust Accounts allowing for electronic verification of reconciliation.*

The stated purpose of this procedure is to safeguard client funds to help ensure accuracy and minimize exposure to loss.

There are three steps required to comply with ALTA Best Practice #2:

- 1) Have a written policy and procedure for escrow account controls;
- 2) Include in your written policy and procedure the necessary elements; and
- 3) Adhere to your policy and procedure.

The Written Policy

There are a number of written policies that govern administration of escrow accounts: the State Bar, Texas Department of Insurance, and/or the Rules of Professional Conduct. ALTA has also proposed uniform procedures regarding escrow accounts through its recommended Best Practice # 2.

While contemplating policy and procedure on escrow accounts, one should consider traditional and non-traditional threats to the escrow account. Most current controls on escrow account management are local controls that think locally and act locally. The controls focus on employees and the access they have to entrusted funds. These proven controls have been solid for many years. Today, however, there are threats that do not enter the office through the door, but through the computer network. One must now think globally as well as locally.

What Should Be Included in the Escrow Account Controls Policy?

- a. **Federally Insured Bank.** All entrusted funds should be kept in a federally insured bank, unless written instructions from the owner of the funds instruct differently. Wherever possible, make sure that there is insurance to protect client funds. **Minimum Escrow Accounting Procedures and Internal Controls (MEAPIC) #21 All escrow or trust accounts maintained by licensed Texas title insurance companies, title insurance agents or direct operations shall be in financial institutions or branches of financial institutions located within the geographic bounds of the State of Texas.**
- b. **Separation of Funds.** All entrusted funds should be kept in a bank account that is separate from all other funds. Supporting documentation for the escrow account should be marked “escrow” account or “trust” account, including checks, deposit tickets, bank statements, bank agreements and all other account related documents **MEAPIC #9 All accounts must be styled as “Escrow” or “Trust”. “Escrow account” “trust account” must appear on the bank statement, the signed bank agreement, disbursement checks and deposit tickets.**

- c. **Authorized Personnel Only.** Transactions regarding entrusted funds should only be performed by authorized employees. In some title companies, the duties of some employees may not require access to the escrow accounts. Other employees may not have the sufficient training for access to the escrow account.

Adequate training of employees with trust account access is necessary to ensure mistakes are kept to a minimum. Additionally, a background check should be made before allowing an employee access to office and escrow accounts. Subsequent checks every three years (going back 5 years) are also a requirement of the Best Practice.

Finally, when an employee leaves, their access to the office, the escrow account and the computer should be terminated immediately. In the old days, employers would simply ask for the key to be returned. Today, employers need to get that key, but also need to terminate employee passwords, change the signature cards (if applicable) and change the alarm code.

- d. **Reconcile Escrow accounts** Client funds in the escrow account require, at a minimum, the same level of care necessary to balance a personal checking account. This means that the account is prepared with trial balances, which match the checkbook and the bank statement. In the event there are open file balances, they must be documented and tracked to resolution. There should never be any negative file balances. When all of this is complete, the monthly three-way reconciliation should be reviewed by management.

Account reconciliation is a proper and vital method of protecting the escrow account. An additional way includes a timeliness that increases security and detection. ALTA Best Practice #2 calls for the daily reconciliation of receipts and disbursements and three-way reconciliation within ten (10) days of the receipt of the bank statement. Once it is performed, the three-way monthly reconciliation must be electronically available for verification by the agency or company's title insurance underwriter. Together, everyone can help protect the entrusted funds.

MEAPIC Numbers

1. ***A monthly escrow trial balance for each individual escrow bank account must be prepared which, at a minimum, lists all open escrow balances. Each month's escrow trial balance must be completed no later than the end of the next month.***
2. ***A three-way reconciliation of bank balance, book balance and escrow trial balance for each individual escrow bank account shall be performed monthly. Each three-way reconciliation must be completed within forty-five (45) days from the closing date of the bank statement of the account.***
3. ***Each reconciliation should be approved by a manager or supervisor. If this is not possible or practical, each reconciliation shall be reviewed by another employee.***
4. ***Each reconciliation should be prepared by someone not associated with the receipt and disbursement function. Where size does not permit this, each reconciliation shall be reviewed by the manager or owner.***

- e. **Segregation of Duties.** When addressing segregation of duties, title companies typically think about separating check writing from check signing authority or separating wire preparation from wire approval authority. Both of these are solid practices and recommended for prudent and practical escrow controls. For compliance with the requirements of Best Practice #2, the reconciliation of the escrow account should be performed by someone without any disbursement authority over the account. This precaution adds a math checker for a simple mistake, and a watchful eye for a greater indiscretion. Whether there is a simple error in math, a wayward employee or a cyber-attack, the employee reconciling the account should not have access to the money.

- f. **Block International Access.** Think globally and be concerned with new threats. Automated Clearing House (“ACH”) transactions are a convenient way to pay by check over the phone, but they also pose a risk for abuse by dishonest people. All that is needed is a routing number, a checking account number and a phone. Just think how convenient and easy that would be for a criminal. There is no place for an ACH transaction on the escrow account. They can easily be blocked by asking the bank to block them.

Another easy protection is an International Wire Block. How often is it necessary to wire funds overseas – outside the jurisdiction of our law enforcement? Requiring additional confirmation before allowing the bank to wire funds to a foreign country may not be an unreasonable hindrance to daily operations. Simply ask the bank to implement the precaution.

- g. **Positive Pay.** Positive Pay is available at almost every bank. This protection requires a little more effort than merely requesting it, but it is worth the effort. Would it not be great if the bank would check with the title company before clearing any escrow account checks? Positive Pay provides the opportunity to communicate electronically with the bank to pre-approve any check that will be presented for payment.

With Positive Pay, as checks are written on the escrow account in the settlement production software, it creates a file that includes every check that is written and uploads it electronically at the bank. The bank then compares every check against the pre-approved list. If the check is not on the list, they contact the title company for approval. No check gets paid unless the bank has approval. With the technology available today, the title company can make this communication by pressing a couple of buttons. Additionally, most Positive Pay connections to the bank are outside of other online banking functions.

Follow the Policy Locally for Global Deterrence

Traditional threats still exist, and we all must continue to be diligent in choosing and training employees. But new threats are emerging every day, as any criminal anywhere in the world armed with only an internet connection can ruin a business. Continue to be diligent on all fronts to protect client money. Anyone can get “hacked.” Whether checking for wrongdoing or a simple mistake, the policies and procedures required for compliance with ALTA Best Practice #2 are not only designed to protect client money, they are designed to protect you, the title insurance agent too, so that when you are asked to “show me the money” by a client or auditor, you can.

Some may assert that many of these policies may alter the way we do business and may make the daily routine more inconvenient or may increase the time spent on the trust account. All are true. But whatever inconvenience we may experience will be exponential to the “would be” criminal in the office or in the computer network. By following these policies, we are protecting client entrusted funds from disappearing and protecting himself or herself from financial disaster, while retaining the ability to “show me the money” when asked.