

ESCROW ADVISORY COMMITTEE MEETING
March 15, 2016

Department of Business Oversight Represented By:

Edgar Gill, Senior Deputy Commissioner
Victor Wells, Deputy Commissioner, Mortgage Lending
Mary Ann Smith, Deputy Commissioner, Enforcement
Richard Malme, Special Administrator
Kathleen Partin, Supervising Examiner
Luhmen Tesoro, Senior Examiner
Ann Davila, Corporation Examiner

Committee Members Present:

Nancy Silberberg, Altus Escrow Inc., Chairperson EIC**
Jeff Behm, Behm and Company, An Accountancy Corp. - CPA
Heidi Birenbaum Cassel, FNF Escrow Holdings - Other Business Ownership
Dave Brooks, Seright Escrow - Small Business
Jennifer Felten, Attorney - RELAW APC
Juliana Tu, Business Specialization - Viva Escrow!
Laura Ghosn, Medium Sized Company - Pickford Escrow Company, Inc.
Bill Nelson – Chairman – EAFC*

*EAFC – Escrow Agents’ Fidelity Corporation

**EIC – Escrow Institute of California

1. Opening Remarks

Richard Malme opened the meeting by thanking everyone for coming. Richard introduced all of the DBO participants and then asked all other committee members to introduce themselves.

2. Review and Approval of the Minutes of Last Meeting

Richard Malme asked if he could have a motion to approve the minutes of December 8, 2015. Nancy Silberberg made a motion to have the minutes approved with the correction of a couple of items under section 5(a) and the motion was seconded; the minutes were approved.

3. Rulemaking Update: Proposed Revisions to Section 1741.5

Richard gave a brief description of this process and how it pertains to procedures for CPA’s to follow when preparing the annual reports. Richard stated that Colleen Monahan is preparing a final draft. The Department had decided to recommend the “Agreed Upon Procedures Engagement” method for CPA’s to use

when completing the procedures. There will be a second public review when the draft is completed.

4. Topics for Discussion

a. Task force of escrow and DBO lenders discussion: Lender TRID Platforms, required costs, and requirement for escrow to be liable for TRID disclosure errors; lenders “blacklisting escrow licensees

Ed Gill asked Nancy Silberberg to explain her position and her request for DBO assistance. Ed also stated that he asked Victor Wells to join the group since he is the Deputy Commissioner of mortgage lending. Nancy wants to bring both lenders and escrow agents together for a discussion of the issues. Ed indicated that the DBO will take a neutral position in this process. The Department will hear from the escrow companies first and then from the mortgage companies.

Nancy brought sample documents from the lenders showing platform fees, etc. and she also introduced Jaqueline from Champion Escrow who was blacklisted by Flagstar Mortgage, with no reason given. This incident occurred just before closing of escrow, and resulted in the transaction being transferred to another escrow company. Flagstar would not communicate on this issue.

Attorney Jennifer Felten shared that she had numerous cases of blacklisting by mortgage companies. She stated that some of her clients had been put out of business because of this, and that they did not know why they were blacklisted.

Nancy continued the discussion with the issue of platform usage fees. Most lenders are now charging fees to escrow companies for using their lending platform.

Heide Cassel stated that the lender is passing on fees to escrow companies that were initially meant for the lender to pay. Escrow companies should only be paying “click fees.”

Nancy stated that lenders are trying to make escrow companies liable for any lender disclosure violations by forcing them to sign indemnification agreements in order to get their business.

Ed Gill stated that “pay to play” is a concern and could be a beginning point of the joint discussions. He also stated that some of the matters presented are outside of DBO’s authority. Ed indicated that these matters would be discussed with our legal department.

Victor Wells stated that he would look into the issue in the upcoming mortgage Round Table discussion.

b. Cyber Security and proper internal controls

Richard stated that 5 companies had been cyber-attacked this first quarter. He stated that there had been \$1.3 million in losses to trust accounts over the last 10 months. If the owners cannot replace the trust funds, the DBO has to take over the company and appoint a conservator. In 7 out of 10 previous losses, the escrow companies received email instructions at closing to redirect the seller's wire. Richard stated that the DBO was very concerned about these losses. Mary Ann Smith, Deputy Commissioner of Enforcement, was introduced.

Mary Ann discussed the Enforcement role when they review a cyber theft incident. She referenced the following sections of the law:

California Financial Code section 17414 (c) – requires licensees to immediately report theft to DBO and EAFC.

California Financial Code section 17414 (a) – prohibits escrow agents from knowingly or recklessly disbursing escrow funds.

California Code of Regulations section 1738 and 1738.2 – prohibits disbursement without instructions and with sound escrow practice.

Mary Ann indicated some of the factors in making our determination for enforcement action are how quickly was theft reported, was this a reckless disbursement (changes in instructions not confirmed, were employees trained to look for potential red flags, etc.) Do you have security systems on your computer? Each incident will be a case by case analysis by the Department for potential action.

Possible enforcement actions that can be taken include, orders to discontinue violations, suspension, or revocation of license.

Jeff Behm, who is on a committee dealing with cyber theft, brought in speakers to talk on this topic. Jeff also stated that escrow companies need to set up procedures for prevention of cyber theft and monitor them regularly.

Next, Lane Elliott (one of the invited speakers) from California Republic Bank spoke on the matter. He handles the banking for about 80 escrow companies. Many companies don't believe that it can happen to them. He stated that human mistakes create system mistakes and cause systems to be infected with malware.

Chris Pierce (also from California Republic Bank) said that some banks require a "hold harmless" agreement in order to recall a fraudulent wire and that it can take up to 6 to 8 weeks to get the funds back. In the cyber thefts they are now seeing, the funds don't go directly to an international banks, but to avoid detection, first are directed to a U.S. bank and then to an international bank.

Next, Richard inquired what the Escrow Institute (EIC) had done to communicate the threat of cyber attack. It was mentioned that EIC will have an upcoming conference and would like the DBO to come and talk about this issue. EIC has also

done email blasts to their members on cyber theft and also has information on their website.

c. Accounting Issues: New rules for deferred taxes and lease accounting

Jeff Behm first discussed deferred taxes. The accounting rules consider them long term assets / liabilities. The DBO has always agreed with this classification.

He stated that the new lease accounting rules have finally been announced. All leases will be on the balance sheet if greater than 1 year. The next 12 months' payments will be considered a current liability and count against the liquid asset requirement. Jeff provided sample financial statements showing before and after scenarios. Richard stated that, in anticipation of this accounting rule change, our legal department has already drafted a rule change to address this issue. We only need to make sure the previously drafted language is still appropriate. It was mentioned that as of 12/15/2019, leases will have to be disclosed under the new rule change. Jeff stated that the DBO should move forward now on this rule change.

5. New Business

a. DBO examination schedule

Kathleen Partin stated that the exam cycle calls for regulatory examination at least every 48 months. She said that right now the Department should be caught up by the end of September on the required cycle. The Department is also doing preliminary exams and also problem companies that are being put on a shorter exam cycle.

b. Social Media Marketing

Juliana Tu shared that her escrow staff is on social media. She said that sometimes they are in contact with real estate agents. Questions asked by Juliana: Do we "Like"? "Share"? Post anything on real estate clients? Is "Sharing" a listing on their website acceptable? Are we helping to market a product? Some licensees have Facebook pages with broker listings. Richard stated that escrow companies are responsible for actions of their employees when escrow law is violated. Kathy stated that promoting is considered a thing of value. Jennifer Felten stated that it's helpful to have the DBO's opinion.

c. Licensing questions and the approval process

Luhmen Tesoro discussed various reasons that delay the license approval process. Some of the items mentioned are as follows:

Manager applications – applicants do not provide current addresses of prior employers, follow-up is needed on the verifications of employment, Statement of Identity's (SIQ's) are not completed correctly, and necessary attachments are not provided.

Main Office applications – No LOEN filing (for issuance of securities), EL 301 is not completed properly, applicant needs to be the escrow company (not the individual), articles of incorporation are missing or their business purpose (to act as escrow agent), no financial statements submitted, and the escrow holder appointed is not qualified.

Branch applications – missing copies of bank reconciliations for existing locations, no increase in surety bond of \$5,000 for each new location, missing SIQ's for existing owners, directors, officers, and managers, and not providing a list of approved managers for each location.

Richard suggested that applicants read the application forms carefully and answer all questions and provide the requested exhibits. Obtaining professional assistance can also help expedite the process.

6. Enforcement actions and licensing update

Richard distributed the handout showing the latest administrative actions and licensing statistics. He mentioned that many of the new applications are coming from broker-owned in-house companies.

Currently, there are 951 licensed locations, with 649 main locations. In 2015 there were 917 locations with 638 main locations. The industry is expanding again.

7. Public Comments

Questions were raised as to whether the management class would cover cyber security and also the type of actions that may be taken against the escrow companies. Richard stated that this information would be part of the class material.

8. Closing Remarks

Richard thanked everyone for coming.

The meeting adjourned at 12:25 p.m. The next meeting is tentatively scheduled for Tuesday, June 21, 2016.