American Escrow Association
Dedicated to Moving the Escrow Settlement Industry Forward

P.O. Box 2211
Loveland, CO 80539

www.a-e-a.org

February 19, 2021

BY ELECTRONIC TRANSMISSION ONLY TO:
regulations@dfpi.ca.gov
re: Escrow Regulation: Recordkeeping Updates & Annual Audit Report
Docket reference--PRO 13/13

Honorable Manuel P. Alvarez
Commissioner of Financial Protection and Innovation
Attn: Regulations Coordinator
Department of Financial Protection and Innovation (DFPI)
300 S. Spring Street, Suite 15513
Los Angeles, California 90013

Dear Commissioner Alvarez:

I am writing on behalf of the members of the American Escrow Association (AEA), the nation's trade association on federal matters for real estate settlement agents. Almost all members work for businesses which provide escrow and other forms of settlement (closing) services within the various states. Members include individuals who work under licenses of entities regulated by the DFPI and others with separately regulated title insurance entities as well as other controlled escrow operations.

We are submitting our views on this proposed rule with request for public comment. We appreciate the open process and this opportunity to place our comments in the public record for the consideration of your Department. Our comments are on the provisions of proposed sec. 1741.7, "Prohibited Compensation," specifically its cited reliance on the federal Real Estate Settlement Procedures Act (RESPA), 12 USC sec. 2607, as amended, which dates back to 1974.

We believe the proposed addition of new Section 1741.7 "Prohibited Compensation" should be withdrawn and reconsidered in a future rulemaking after additional legal review of RESPA; in particular the "section 8" raw referral fee compensation prohibitions expressed in the governing provisions and case law referred to below. And that, in advance of re-issuing a proposed Rule, the Department should consult with affected persons and the federal regulator, the Bureau of Consumer Protection (CFPB). The Department of Housing and Urban Development, which previously regulated section 8 of RESPA, did not take an "easy to prove" (based on a mere descriptive/labeling approach) to allegations of section 8 violations in regulations; nor in our more recent experience has the CFPB. Rather they and the courts recognize that an intensive factual scrutiny, analysis and findings therefrom often may be needed to establish a prohibited referral fee violation.

Specifically, the DFPI states on page 39 of the supporting reasons that "RESPA violations are also escrow violations pursuant to Financial Code section 17425. In order to prove one of these activities is an escrow violation due to association with a RESPA violation, the Department must find a RESPA violation." We do not question those statements. The problem we see is in the precise approach to providing clarity. The sec. 1741.7(a) list of violations reads like an enforcement bulletin and a statement of Department enforcement policy based on actual cases in which the facts were scrutinized. If it were to be an enforcement bulletin providing a clear warning that is fine. But this is a statement of positive regulatory law that has to rely on statutory authority to promulgate it. We don't see that in this proposal. We see a list of per se violations of law. We do not believe the approach taken adheres to the federal Reg X (12 CFR Part 1024) implementing RESPA and federal case law as follows.

Reg. X section 1024.14 "Prohibition against kickbacks and unearned fees," the so-called section 8 rules for determining whether a violation of law may have occurred, is a prohibition against raw referral fees reflecting Congress' concerns that compensation arrangements purely for the referral of business are generally to be prohibited unless explicitly allowed under law. Reg X is broad in definitional coverage to include what can be a "thing of value" and thus potentially a section 8 violation. That phrase "thing of value" appears to be the focal point of the proposed sec. 1741.7(a) 1-9 identified activities as deemed violations (prohibited compensation).

We believe proposed sec. 1741.7(a) in its entirety fails to follow Reg. X. Reg. X is not a list of per se violations. It gives definitional guidance and coverage, and just as importantly articulates what is permitted compensation. It bans referral fees as broadly defined (sec. 1024.14(b)); it then bans splits of charges unless for actual

services rendered (sec. 1024.14(c); it then defines broadly a "thing of value," an "agreement or understanding," and the term "referral" in secs. 1024.14 (d), (e), and (f) respectively. Very importantly it concludes with a list of permitted compensation to provide clarity. We note proposed sec. 1741.7 (b) is substantially similar to Reg. X sec. 1024.14 (e) cited above; proposed sec. 1741.7(a) is not substantially similar to Reg X in large part.

The Department indicates it may become aware of an asserted violation "but not have access to a contract that shows there was an agreement about the compensation." We understand that requires scrutiny of course of conduct, pattern or practice in particular repeated instances of such conduct. That should not be addressed by enforcement conclusions built into positive law, but only through clear evidence established by sufficient supporting factual developments and findings and our concern is the proposal fails to consider factual development at all.

The Department's approach is also not consistent with RESPA as expressed in controlling federal case law. For example in the case of *Merritt v. Countrywide Fin. Corp*., 759 F.3d 1023 (9th Cir. 2014) the 9th Circuit considered, among other issues, whether an inflated appraisal was a "thing of value" and a section 8(a) violation under RESPA. In their opinion they stated that the "answer is not self-evident" and "Moreover, the determination may depend on factual development as to the precise structure of the agreement and the sequence of events." The deemed violation approach of the Department does not recognize and does not build into the Rule such cases.

Because the Department has taken a self-evident approach in its efforts to provide clarity in this Rule, we believe it is fundamentally flawed and should be withdrawn for reconsideration. The audit, annual reports and CPA related procedures of the remainder of the proposal are in their third round prior to final rulemaking and we believe at least a second round is needed for the compensation-related provisions under proposed sec. 1741.7. Finally we note SB 133 (Aanestad), cited in the footnotes to the reasons given; that is state statutory law so obviously supported by legislation. Proposed sec. 1741.7 is not.

Thank you for your consideration of our comments.

Our primary drafter and his contact number for questions is:

Arthur E Davis III
Washington DC Representative
American Escrow Association
art.davis@a-e-a.org; mobile 703-625-9288

Sincerely,

Carlye Buxton

Carlye Buxton
2020-2021 President
American Escrow Association