September 13, 2021

BY ELECTRONIC TRANSMISSION ONLY TO:
regulations@dfpi.ca.gov
re: PRO 13/13—Modifications to Proposed Text

Christopher S. Shultz
Acting 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 Acting Commissioner Shultz:

We are 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 and the Real Estate Services Providers Council Inc. (RESPRO®). Almost all members of AEA work for businesses which provide real estate closing, in particular escrow settlement services, among and within the various states including California. Members include individuals who work under licenses of entities regulated by the DFPI and others who are employed by separately regulated title insurance entities as well as other controlled escrow operations. Many AEA California members also work with members of RESPRO® who also have significant operations in California. We both commented previously on February 19, 2021 on the initial PRO 13/13 provisions of proposed sec. 1741.7, "Prohibited Compensation," specifically its cited reliance on the federal Real Estate SettlementProcedures Act (RESPA), 12 U.S.C. sec. 2601, *et seq.*

We are submitting our views on this modified proposal with request for a public hearing. We appreciate the open process and this opportunity to place our comments in the public record for the consideration of your Department. Our comments renew and restate our prior comments with more specificity regarding the proper application of the guiding provisions of RESPA to the provisions of this proposed sec. 1741.7, "Prohibited Compensation."

Our initial comments are on the statements in the "INITIAL STATEMENT OF REASONS FOR PROPOSED REGULATORY ACTION" (2020) which say (at page 39):

"Financial Code section 17420, lacks clarity regarding escrow referral compensations. Federal law specifies what activities are not prohibited as "kickbacks" under the Real

Estate Settlement Procedures Act (RESPA). The inconsistency between state and federal law has been an issue for years."

We don't question the description of the CA statute. However, the Department's RESPA statement for purposes of comparing and contrasting federal and state law is incomplete to the point of being grossly misleading and inaccurate. The relevant provision is section 8 of RESPA, a reference to the enrolled bill's numbering system from 1974. As codified this is 12 U.S.C. sec. 2607 "Prohibition against kickbacks and unearned fees." It is supplemented by two federal regulatory provisions:

(a) The regulatory text in 12 CFR 1024.14---12 CFR 1024 is generally referred to as Regulation X---which importantly, given the statutory language requiring the presence (whether accepted or given) of a "fee, kickback, or thing of value" for the "referral" of settlement business, provides added helpful guidance. This includes guidance on what the phrase "no referral fees" means, and defining what the terms "thing of value," "agreement or understanding," and "referral" mean, along with examples of permitted compensation.

(b) Appendix B to Part 1024—Illustrations of the Requirements of RESPA which includes a number of examples on the meaning and coverage of the prohibition against kickbacks and unearned fees.

Accordingly the RESPA law is much more substantial and developed than stated by the Department in its reasons.

In addition we don't see any current inconsistencies between the cited provisions. The current federal law is simply more elaborative. After reviewing California Code of Regulations 10 C.C.R. as currently published it is our understanding that sec. 1741.7 would be a brand-new added provision. If the statutory formulation (under **CHAPTER 3. Escrow Regulations [17400 - 17425])** is not detailed enough as a legislative regulation, there is an alternative solution, in the absence of clarifying legislation, to the "deemed" compensation approach being proposed (as modified). That would be a set of examination procedures which would determine if escrow engages in any practices prohibited by RESPA or Regulation X, such as kickbacks, payment or receipt of referral fees, as impermissible compensation and make it applicable for California purposes. Two components of that determination could be:

(1) Through interviews with company management and reviews of audits, policies, and procedures or other appropriate methods, determine if management is aware of the prohibition against payment and receipt of any fee, kickback, or thing of value in return for the referral of settlement services business; and

(2) Determine whether any fees paid or received by the company are for goods or facilities actually furnished or services actually performed and are not, under the circumstances, kickbacks or referral fees. Making the determination is through

interviews with institution management and personnel, file reviews, settlement statement (including Closing Disclosure) reviews, and identifying persons or entities to or from which there is a referral of settlement services business.

We add in recommending this approach, as well as recommending your withdrawal of the entirety of proposed sec. 1741.7, that while we do not have expertise in California Financial Code Division 6 Section 17420 we can and do note the language "……or other consideration as compensation for referring (highlighting emphasis added)." This matches RESPA on the face of the wording, even if in a different order and with some differences of specific words, and it requires two separate determinations—first that consideration flows between escrow and another entity "as compensation" and second that it was "for referring." There is no deeming of consideration as always being for referring in either statute as well as not in the developed law under RESPA. However that is what this proposal, even as modified, attempts to do. Again given the development of RESPA through Regulation X including the Appendix with examples, with proper examination technique and procedures the Department can determine when a case is appropriate, under the circumstances, for enforcement proceedings

Further comments on the relevant examples of that Appendix B, copied below, make even clearer our points above as to a violation only occurs if there is both (a) something of value being given or received; and (b) it being for a referral:

"The following illustrations provide additional guidance on the meaning and coverage of the provisions of RESPA. Other provisions of Federal or state law may also be applicable to the practices and payments discussed in the following illustrations.

1. Facts: A, a provider of settlement services, provides settlement services at abnormally low rates or at no charge at all to B, a builder, in connection with a subdivision being developed by B. B agrees to refer purchasers of the completed homes in the subdivision to A for the purchase of settlement services in connection with the sale of individual lots by B.

Comments: The rendering of services by A to B at little or no charge constitutes a thing of value given by A to B in return for the referral of settlement services business, and both A and B are in violation of section 8 of RESPA.

2. Facts: B, a lender, encourages persons who receive federally related mortgage loans from it to employ A, an attorney, to perform title searches and related settlement services in connection with their transaction. B and A have an understanding that in return for the referral of this business A provides legal services to B or B's officers or employees at abnormally low rates or for no charge.

Comments: Both A and B are in violation of section 8 of RESPA. Similarly, if an attorney gives a portion of his or her fees to another attorney, a lender, a real estate broker or any other provider of settlement services, who had referred prospective clients to the attorney, section 8 would be violated by both persons.

3. Facts: A, a real estate broker, obtains all necessary licenses under state law to act as a title insurance agent. A refers individuals who are purchasing homes in transactions in which A participates as a broker to B, an unaffiliated title company, for the purchase of title insurance services. A performs minimal, if any, title services in connection with the issuance of the title insurance policy (such as placing an application with the title company). B pays A a commission (or A retains a portion of the title insurance premium) for the transactions or alternatively B receives a portion of the premium paid directly from the purchaser.

Comments: The payment of a commission or portion of the title insurance premium by B to A, or receipt of a portion of the payment for title insurance under circumstances where no substantial services are being performed by A, is a violation of section 8 of RESPA. It makes no difference whether the payment comes from B or the purchaser. The amount of the payment must bear a reasonable relationship to the services rendered. Here A really is being compensated for a referral of business to B.

4. Facts: A is an attorney who, as a part of his legal representation of clients in residential real estate transactions, orders and reviews title insurance policies for his clients. A enters into a contract with B, a title company, to be an agent of B under a program set up by B. Under the agreement, A agrees to prepare and forward title insurance applications to B, to re-examine the preliminary title commitment for accuracy and if he chooses to attempt to clear exceptions to the title policy before closing. A agrees to assume liability for waiving certain exceptions to title, but never exercises this authority. B performs the necessary title search and examination work, determines insurability of title, prepares documents containing substantive information in title commitments, handles closings for A's clients and issues title policies. A receives a fee from his client for legal services and an additional fee for his title agent "services" from the client's title insurance premium to B.

Comments: A and B are violating section 8 of RESPA. Here, A's clients are being double billed because the work A performs as a "title agent" is that which he already performs for his client in his capacity as an attorney. For A to receive a separate payment as a title agent, A must perform necessary core title work and may not contract out the work. To receive additional compensation as a title agent for this transaction, A must provide his client with core title agent services for which he assumes liability, and which includes at a minimum, the evaluation of the title search to determine insurability of the title, and the issuance of a title commitment where customary, the clearance of underwriting objections, and the actual issuance of the policy or policies on behalf of the title company. A may not be compensated for the mere re-examination of work performed by B. Here, A is not performing these services and may not be compensated as a title agent under section 8(c)(1)(B). Referral fees or splits of fees may not be disguised as title agent commissions when the core title agent work is not performed. Further, because B created the program and gave A the opportunity to collect fees (a thing of value) in exchange for the referral of settlement service business, it has violated section 8 of RESPA.

5. Facts: A, a "mortgage originator," receives loan applications, funds the loans with its own money or with a wholesale line of credit for which A is liable, and closes the loans in A's own name. Subsequently, B, a mortgage lender, purchases the loans and compensates A for the value of the loans, as well as for any mortgage servicing rights.

Comments: Compensation for the sale of a mortgage loan and servicing rights constitutes a secondary market transaction, rather than a referral fee, and is beyond the scope of section 8 of RESPA. For purposes of section 8, in determining whether a *bona fide* transfer of the loan obligation has taken place, the Bureau examines the real source of funding, and the real interest of the named settlement lender.

6. Facts. A, a credit reporting company, places a facsimile transmission machine (FAX) in the office of B, a mortgage lender, so that B can easily transmit requests for credit reports and A can respond. A supplies the FAX machine at no cost or at a reduced rental rate based on the number of credit reports ordered.

Comments: Either situation violates section 8 of RESPA. The FAX machine is a thing of value that A provides in exchange for the referral of business from B. Copying machines, computer terminals, printers, or other like items which have general use to the recipient and which are given in exchange for referrals of business also violate RESPA.

The examples actually represent the result of developing sufficient facts and making the record under the circumstances that a violation has occurred when <u>all</u> requisite elements are met. The Department needs to consider before moving forward that the RESPA examples, contrary to the proposed sec. 1741.7 language, make clear that an impermissible payment or thing of value has to be determined to be <u>for</u> a referral under the circumstances. The term "deem" or its equivalent is not in the examples in any form. Therefore, in deeming certain business practices as consideration for referring business in all instances of the listed categories the DFPI proposal would create an inconsistency that does not currently exist. Therefore we categorically refute the initial statement of reasons that there is a current inconsistency. Your Department is about to create one if you move forward with this modified language.

Our final comments are that in light of the created inconsistency that would follow from this proposal as currently written, and as proposed to be modified, this would invoke 12 U.S.C. sec, 2616 which states:

> "This chapter does not annul, alter, or affect, or exempt any person subject to the provisions of this chapter from complying with, the laws of any State with respect to

> settlement practices, except to the extent that those laws are inconsistent with any provision of this chapter, and then only to the extent of the inconsistency. The Bureau is authorized to determine whether such inconsistencies exist. The Bureau may not determine that any State law is inconsistent with any provision of this chapter if the Bureau determines that such law gives greater protection to the consumer. In making these determinations the Bureau shall consult with the appropriate Federal agencies."

We believe that if the Department insists on taking a "deemed" linking approach to the consideration-for the purpose of a referral determination, rather than an "under the circumstances" approach it must recognize it has created an inconsistency with federal law and that it will be incumbent on the Department to seek the determinations described in the RESPA statute from the federal Consumer Financial Protection Bureau. That will include establishing that the deemed approach is more protective of consumers for sec. 1741.7 to stand. We believe that on closer scrutiny it will be found that much of what you may believe to be per se violations of law are healthy free market competitive business practices totally free from any unearned compensation and therefore provide benefits to consumers without diminishing any protections under federal or state law.

In summary we believe our recommended alternative represents a far better administrative practice to address the DFPI's concerns about the state of the law in California and can immediately be implemented pending a future legislative solution.

Thank you for your consideration of our comments.

Sincerely,

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