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September 13, 2021

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To: Regulations Division  
To: Sherri Kaufman, Esq.  
Department of Financial Protection & Innovation  
300 South Spring Street, Suite 15513  
Los Angeles, California 90013

Re: **Modifications of Text of Proposed Regulations Under  
the Escrow Law [PRO 13/13] - Dated August 27, 2021**

Dear Ms. Kaufman and Regulations Section,

This letter regards the Modifications of Text of Proposed Regulations Under the Escrow Law [PRO 13/13] published by the Commissioner of the Department of Financial Protection & Innovation [DFPI] on August 27, 2021. My law firm now and has for many years represented escrow companies licensed by the DFPI.

Although the Commissioner published a number of Proposed Regulations affecting the financial affairs of licensed escrow companies, closing of licensee's business and the like, the focus of the comments in this letter pertain to the Proposed Regulations in adding a new CCR §1741.7 Prohibited Compensation. For your convenient reference, we have attached a copy of the Commissioner's proposed text regarding the new proposed CCR §1741.7 with its related subsections.

The Commissioner recites the authority of Financial Code §17420 as support for the Proposed Regulations including the new CCR §1741.7. For the reasons set forth herein, we propose that the Commissioner withdraw the present iteration of CCR §1741.7 given the lack of authority for the form and content of Proposed Regulations. We also ask the Commissioner not to act outside the Commissioner's authority in continuing to advance Proposed Regulations which exceed the Commissioner's authority. Instead, the Commissioner may act to propose legislative changes to the Escrow Law if the Commissioner is of a mind to move forward with the Propose Regulations.

**1. Considerations For Withdrawal of CCR §1741.7. Prohibited Compensation.**

**A. Financial Code §17420.** Financial Code §17420 was amended 60 years ago in 1961 under Chapter 475 and has had no later legislative amendments. The California Legislature approved the following language referencing compensation for referring, soliciting or servicing customers and accounts:

*"Except for the normal compensation of his own employees, it shall be a violation of this division for any person subject to this division to pay over to any other person any commission, fee, or other consideration as compensation for referring, soliciting, handling, or servicing escrow customers or accounts. It shall also be a violation for any person to enter into any arrangement, either of his own making or of a subsidiary nature, or through any other person having a dual capacity, or through any person having a direct or indirect interest in the escrow, or other device permitting any fee, commission, or compensation which is contingent upon the performance of any act, condition, or instruction set forth in an escrow to be drawn or paid, either in whole or in part, or in kind or its equivalent, prior to the actual closing and completion of the escrow." (Amended by Stats. 1961, Ch. 475)*

**B. Government Code §11342.1.** Government Code §11342.1 was amended 34 years ago in 1987 under Chapter 1375, Sec. 2 and has no later legislative amendments. The California Legislature approved the following language which states:

*"Except as provided in Section 11342.4, nothing in this chapter confers authority upon or augments the authority of any state agency to adopt, administer, or enforce any regulation. Each regulation adopted, to be effective, shall be within the scope of authority conferred and in accordance with standards prescribed by other provisions of law." (Amended by Stats. 1987, Ch. 1375, Sec. 2.)*

**C. Government Code §11342.2.** Government Code §11342.2 was enacted 42 years ago in 1979 under Chapter 567 and has no later legislative



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amendments. The California Legislature approved the following language which states:

*"Whenever by the express or implied terms of any statute a state agency has authority to adopt regulations to implement, interpret, make specific or otherwise carry out the provisions of the statute, no regulation adopted is valid or effective unless consistent and not in conflict with the statute and reasonably necessary to effectuate the purpose of the statute." (Added by Stats. 1979, Ch. 567.).*

D. **Association of California Insurance Companies vs. Jones** [2017] 2 Cal 5<sup>th</sup> 376, 212 Cal. Rptr. 3d 395. In the *Association of California Insurance Companies* case, the California Supreme Court affirmed, among other provisions, that the Commissioner of Insurance in the Commissioner's rulemaking powers must abide by Government Code §11342.2. The case states in part:

*"Government Code §§ 11342.1 and 11342.2 set forth the requirements for a state agency to implement a regulation and the test to determine the validity of a regulation.*

*The scope of the agency's regulation adoption authority is set forth in Government Code § 11342.1, which states that "each regulation adopted, to be effective, shall be within the scope of authority conferred and in accordance with standards prescribed by other provisions of law." The agency's practical interpretation of a statute in the adoption of reasonable rules to assist in procedural administration is entitled to great weight and respect to the agency's construction. [5]*

*The test to determine the validity of a regulation is further set forth in Government Code § 11342.2 which states that "no regulation adopted is valid or effective unless consistent and not in conflict with the statute and reasonably necessary to effectuate the purpose of the statute."*

E. **California Office of Administrative Law.** As set forth at the website of the California Office of Administrative Law at [www.oal.ca.gov](http://www.oal.ca.gov) [[https://oal.ca.gov/rulemaking\\_process/](https://oal.ca.gov/rulemaking_process/)], the definition of a "regulation" is posted which states:

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*"A "regulation" is any rule, regulation, order or standard of general application or the amendment, supplement, or revision of any rule, regulation, order, or standard adopted by any state agency to implement, interpret, or make specific the law enforced or administered by it. When adopting regulations, every department, division, office, officer, bureau, board or commission in the executive branch of the California state government must follow the rulemaking procedures in the Administrative Procedure Act (APA) (Government Code section 11340 et seq.) and regulations adopted by the Office of Administrative Law (OAL), unless expressly exempted by statute from some or all of these requirements. The APA requirements are designed to provide the public with a meaningful opportunity to participate in the adoption of regulations or rules that have the force of law by California state agencies and to ensure the creation of an adequate record for the OAL and judicial review."*

F. **DFPI Internet Site Statement re Escrow Fees.** At the Internet site of the DFPI at <https://dfpi.ca.gov/escrow-law-frequently-asked-questions> of the document posted entitled "Escrow Law – Frequently Asked Questions", Question No. 13 states:

"13. ARE THE FEES ESCROW AGENTS CHARGE FOR THEIR SERVICES REGULATED? The Escrow Law does not restrict the fees that escrow agents may charge for services. The amounts escrow agents charge for their services vary depending on the location of the escrow agent, type of transaction and the competition in the area. The escrow agent is required to disclose all fees on the closing statement that is prepared after the transaction is completed. It is recommended that you request the escrow agent provide you with a fee schedule that shows the charges for their services."

G. **RESPA, Section 8 Prohibits Kickbacks, But Not Discounts of Escrow Fees to the Public.** The Consumer Financial Protection Bureau [CFPB] regulates the provisions of the Real Estate Settlement Procedures Act [RESPA]. Prior to 2011, RESPA was enforced by the U.S. Department of Housing & Urban Development [HUD]. RESPA does not apply to all types of transactions being limited to transactions affecting residential real estate in connection with a federally related loans. Thus, commercial property, bulk sales, vacant land and other types of transactions are not affected by RESPA.



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At Section 8, RESPA prohibits a person from giving or accepting anything of value for referrals of settlement service business related to a federally related mortgage loan. It also prohibits a person from giving or accepting any part of a charge for services that are not actually performed. At RESPA §8(a), it prohibits the giving or accepting of kickbacks as defined in RESPA and Regulation X as a "thing of value" under any agreement or understanding to refer settlement service business or business incident to a real estate settlement service in connection with federally related mortgage loans.

**2. Provisions of Proposed CCR §1741.7. Prohibited Compensation.**

**A. Overall Considerations.** The provisions of the Proposed Regulation prohibiting compensation overall exceeds the authority of the Commissioner who is relying on the limited provisions of Financial Code §17420. Government Code §§ 11342.1 and 11342.2 makes it clear that the Commissioner does not have unfettered power to impose regulations outside the statutory delimitation upon which it relies. This point was confirmed by the California Supreme Court in the above referenced Association of California Insurance Companies case.

The effort of the Commissioner overall to prohibit compensation paid to escrow companies, disallow them to offer free or discounted escrow fees to public members, and go so far as to limit the parties to escrow transactions from changing the manner in which escrow fees are paid where they are different than the contract they signed. In regard to the latter, the parties to real estate and other contracts are permitted to change and amend any provisions they wish upon their mutual agreement, but the Commissioner would prohibit them from changing the manner of paying an escrow fee? With all due respect, that appears patently unreasonable as the Commissioner has no administrative authority over the parties to escrow transactions.

**B. Attempt to Extend the Provisions of Financial Code §17420 without Legislative Approval.** The provisions of Financial Code §17420 in its first sentence states that *"Except for the normal compensation of his own employees, it shall be a violation of this division for any person subject to this division to pay over to any other person any commission, fee, or other consideration as compensation for referring, soliciting, handling, or servicing escrow customers or accounts."*

Since the Commissioner is relying on the provisions of Financial Code §17420 for the broad scope of Proposed Regulations, it should be noted that all provisions of Proposed Regulation at CCR §1741.7 go well beyond any provision



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of the code section as a basis for any of the regulations. It is and has been for some time a requirement for licensed escrow companies not to pay kickbacks to persons for "referring, soliciting, handling or servicing escrow customers or accounts". However, for example, it does not limit providing free or discounted escrow fees to public members or otherwise operating a business that provides escrow services.

The second sentence of Financial Code §17420 states, *"It shall also be a violation for any person to enter into any arrangement, either of his own making or of a subsidiary nature, or through any other person having a dual capacity, or through any person having a direct or indirect interest in the escrow, or other device permitting any fee, commission, or compensation which is contingent upon the performance of any act, condition, or instruction set forth in an escrow to be drawn or paid, either in whole or in part, or in kind or its equivalent, prior to the actual closing and completion of the escrow."*

The provisions of the second sentence of Financial Code §17420 provides that fees, commissions and compensation contingent upon the performance of an act such as the close of escrow, not be paid over to anyone until the closing. Thus, the extent of the present iteration of the Proposed Regulations is well outside the provisions of the Government Code at §§ 11342.1 and 11342.2 which state that no regulation can be adopted as valid or effective provisions unless consistent and not in conflict with the statute and reasonably necessary to effectuate the purpose of the statute.

**C. There Is No Fee Setting or Escrow Fee Schedules Required To Be Maintained by Escrow Companies Under the Escrow Law.**

Notwithstanding there is no requirement under the Financial Code for the setting of escrow fees or the maintenance of an escrow fee schedule as well as prohibiting the parties to the escrow to amend the manner of payment of escrow fees, it appears the Commissioner is attempting to impose through the back door by imposing Regulations in the form proposed by Commissioner without proper statutory authority under the new CCR §1741.7 in its various proposed subsections.

Financial Code §17420 does not delimit escrow fees, prohibit discounts or free escrows for the parties to the escrow, prohibit parties to the escrow from amending their contracts or otherwise contain language that is consistent with the Financial Code. Thus, the Commissioner appears to be acting outside of the provisions of Government Code §§ 11342.1 and 11342.2 with the Proposed

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Regulations which are overly broad and vague and unclear given the lack of statutory authority.

In summary, we ask that the Commissioner withdraw the Proposed Regulations under CCR §1741.7 given the proposals appear outside the authority of the Commissioner and specifically do not "...implement, interpret, make specific or otherwise carry out the provisions"...of Financial Code §17420 or any other code section now contained in the Escrow Law [Financial Code §§17000, et seq.]. Please advise if you have any questions concerning the within information.

Best regards,



Rose Pothier  
Attorney At Law

Enclosure

RP/az/DFPI/P13-13



(5) Identify the escrows opened during the 45 days prior to the cessation of business. Examine the dispositions of these escrows for any ~~unusual~~ irregular activity (i.e., the failure to follow escrow instructions, incorrect or non-disclosure on settlement statement(s)). Describe the ~~unusual~~ irregular activity in the report of finding.

(6) Verify whether the licensee has escheated all remaining trust funds in accordance with Code of Civil Procedure section 1517. Describe in the report of findings whether the total of all trust funds have been escheated to the state.

(7) Include in the report of findings the name, phone number, email and mailing address of the licensee's appointed custodian of records and the location address of the escrow files and accounting records.

(c) The licensee must ensure the practitioner performs all of the procedures required by this rule and includes in the closing report of findings a description of all the above procedures performed and the results of each procedure.

(d) The licensee must ensure the practitioner submits the report of findings directly to the Commissioner and includes in the report a copy of the trust account ~~bank~~ reconciliations, ~~bank~~ financial institution statements, list of outstanding checks, trial balances, and proof of remittance of all remaining trust funds to the State Controller's Office, for the following months: the month prior to the cessation of business of the licensee, the month of cessation, and the month following the cessation of business.

Note: Authority cited: ~~17315~~, Sections 17400 and 17406, Financial Code. Reference:

Sections 17403.5, 17404, 17406 and 17409, Financial Code.

6. Section 1741.7 is added to read:

§ 1741.7. Prohibited Compensation



(a) The following activities, constitute consideration, whether performed directly or indirectly, ~~are deemed a commission, fee, or other consideration as compensation~~ as compensation for ~~an escrow agent~~ referring, soliciting, handling or servicing escrow customers or accounts, in violation of Financial Code section 17420 ~~and are prohibited~~:

(1) Paying or offering to pay, furnishing or offering to furnish, or providing or offering to provide assistance with the business expenses of any person, including, but not limited to, rent, employee salaries, furniture, copiers, facsimile machines, automobiles, training, marketing expenses, insurance coverage, office space, accounting services, telephone services, ~~or other services~~, equipment, or computers.

(2) Advertising or paying for an advertisement ~~the advertising~~ in any newspaper, newsletter, magazine, publication, broadcast television, ~~the Internet, or podcast,~~ online video or online media, ~~or application which enable users to create and share content or to participate in social networking on behalf of any person.~~

(3) ~~Sharing content generated by or on behalf of another person on the Internet or an application which enables users to create and share content or to participate in social networking.~~

(34) Expenditures for foods, beverages and entertainment for a person or catering events.

(45) Furnishing or offering to furnish all or any part of the time or productive effort of any employee of the escrow agent to any person for any service unrelated to the escrow business.

(56) Offering free escrow services to one or more parties to the escrow.

(67) Offering escrow services at rates below the escrow agent's fee schedule, unless the discount meets the following conditions:

(A) The discount is available to all principals in the same transaction meeting the conditions or status for the discount;

(B) The discount from the fee schedule is mutually agreed upon by all parties to the escrow and substantiated by written escrow amendments and the amount of fees are explicitly disclosed on the written instruction;

(C) The discount does not contravene the distribution of escrow fees agreed upon by the parties to the escrow in a purchase or other agreement;

~~(D) The discount is not of a size or nature that will affect the independence of the escrow agent in the transaction; and~~

~~(DE) The discount does not result in one or more parties to an escrow covering the cost of escrow services for another party to the escrow, unless this allocation of escrow fees was made between the parties to the escrow without regard to the discount.~~

(8) Offering a discounted rate to clients of a broker without making the discount available to clients of all brokers.

(9) Offering a discounted rate to a broker, where the broker is the principal to the transaction.

(b) An arrangement of an escrow agent paying over to any other person any commission, fee, or other consideration as compensation for referring, soliciting, handling, or servicing escrow customers or accounts need not be written or verbalized but may be established by practice, pattern or course of conduct.



Note: Authority cited: ~~17315, Section 17400 and 17406~~; Financial Code. Reference:  
Section 17420, Financial Code.

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