

ESCROW ADVISORY COMMITTEE MEETING

June 13, 2023

10:00 AM – 12:00 PM

320 West 4th Street, 7th floor conference room, Los Angeles, CA 90013

Or via. Microsoft Team

Department of Financial Protection and Innovation Represented by:

Paul Liang, Assistant Deputy Commissioner

Gary Suzuki, Special Administrator – Regulatory

Sultanna Wan, Special Administrator - Licensing

Committee Members:

Benjamin Griffin, Griffin, P.C. / Attorney

Claire Bartos, Las Brisas Escrow, Inc. / Immediate Past Chairperson EIC *

Heidi Cassel, Solaris Escrow, Inc. / Medium Sized Escrow Company

Juliana Tu, Viva Escrow! Inc. / Business Specialization

Larry Black via phone, Diamond Country Escrow, Inc. / Small Business

Patricia J. (P.J.) Garcia, Beach Pacific Escrow, Inc./Chairperson EIC *

Patrick Felde, Certified Public Accountant

* Escrow Institute of California

** Escrow Agents' Fidelity Corporation

1. Welcome, Opening Remarks

Paul Liang welcomed advisory committee members who attended the meeting either in person or virtually. Liang introduced Sultanna Wan as the new Licensing Special Administrator for the escrow law program. Wan has been with the escrow law program for about 13 years. Prior to joining the Department, Wan worked in public accounting in various firms. Wan has an accounting degree and MBA, and she's been a California licensed CPA for about 20 years.

Liang stated for future meetings, the first order of business is to do a roll call to ensure there is a quorum to allow the committee to continue its meeting. Future meetings will strictly follow the published meeting agenda. Anything that is not on the agenda could be discussed during the public comment session. Members of the public may participate in discussion during the public comment session.

2. Review and Approval of Minutes for 6/13/23 meeting

Advisory members were provided with the last meeting minutes prior to the current meeting. Advisory members do not have any corrections or comments for the minutes. Juliana Tu made a motion to approve the minutes. Heidi Cassel seconded the motion. The minute was approved.

3. Q&A from 2023 EIC Conference

Liang stated Greg Young, Senior Deputy Commissioner and Sheila Oliver, Deputy Commissioner attended Escrow Institute of California's annual conference. Young and Oliver participated in a Q&A during the conference. Due to time constraints, some of the questions brought up during the

conference were not answered. Young and Oliver asked the program to go over those questions during the committee meeting. Liang provided a response to the following questions:

- 1) What are the escrow file retention requirements if a company wishes to surrender its license?

During the surrender process, a licensee is required to provide the DFPI its post-surrender location of escrow records and the name and contact information for the custodian of records. Licensees may choose to preserve their escrow records electronically or in hard copy. Escrow records are required to be preserved for at least five years from the close of escrow.

Liang stated this question came up from time to time. Licensees are encouraged to email their questions regarding the surrender requirements and processes to Escrow.Licensing@dfpi.ca.gov. Emails to this account are being monitored daily. A licensing examiner will reach out and provide guidance.

Liang also stated licensees should be mindful if they are 100% paperless. Records are often lost or purged in the old accounting system when a licensee switches to a new system. There are accounting software providers actively promote their services to the escrow industry. Licensees should understand the level of services provided by these software vendors and are encouraged to consult with their accountants when switching systems. If not done properly, it could be very costly to make corrections and there may be potential violations of record retention requirements in the escrow law.

Heidi Cassel suggested licensees work with their accounting system provider to ask them to download all information on a thumb drive so the custodian of records can go through records in specific years to retrieve the data. PJ Garcia commented that backing up data is also important when there is a ransomware attack.

Liang reiterated that it is important to communicate with licensees' software providers to make sure licensees are not losing data when switching systems. The Department is concerned about loss of data. In the past, the Department's examiners have found licensees lost electronic data for a recently surrendered branch office due to switching accounting software. The data in the old system was lost because licensee did not download a copy in a storage medium or continue their subscription to the old system. Upon cancelling the old system subscription, the data was purged by the software provider.

- 2) If a seller is a business trust whose trustee is a single member LLC or a corporation, can the seller's proceeds be made payable to the individual person who's the single member of LLC or sole shareholder of the corporation.

Liang stated seller's proceeds should go to the seller unless there is a valid substantiation such as a court order instructing licensee to disburse proceeds to person or entity other than the seller. This may happen when the sellers are husband and wife joint tenants selling a house in a divorce.

Benjamin Griffin suggested licensees to scrutinize those court orders because sometimes an order may address a divorce but not the proceeds. Cassel suggested licensees remain neutral and ask the seller(s) to get legal advice as there may be tax consequences.

Liang stated if a licensee follows the instructions from the principals to disburse proceeds to seller(s) of the transaction, there is no apparent escrow violation. Licensees are encouraged to disburse proceeds promptly to avoid proceeds being turned into a holding escrow. Licensees

should also be aware it may be outside of the scope of escrow to provide bookkeeping and bill payment services to the seller for their funds in the trust account.

Larry Black questioned if a licensee holds rent or security deposit post-closing, would the funds being held be considered a holding escrow. Liang stated whether any remaining funds in the escrow would be considered as turning into holding escrow requires a review on a case-by-case basis. Typically, post-closing funds being held for repair, termite works, etc. are not considered as holding escrow. If the licensee needs to open a holding escrow, it needs to have separate books, records, account, and fidelity bond.

Cassel asked if the Department has a list of licensees who handle holding escrows. Liang stated the DFPI does not keep such list because licensees may choose to take holding escrows or to discontinue providing holding escrow services anytime. The Department does not have real time data to compile such a list.

- 3) Would the Department's examiner take exception if a clear check is not endorsed?

Liang stated this does not appear to be an exception in and of itself. Most banks will process a check without endorsement if the check is deposited in an ATM machine or via mobile deposit. If this is an exception for a licensee's recent examination, licensees may contact the examination supervisor for clarification. Cassel commented that if a licensee's bank is savvy enough, it would contact licensee to inquire whether to pay or not pay an unendorsed check because positive pay presented to the bank on a daily basis lists the payees for the checks. A bank should check the front and back of the check and contact client if needed.

- 4) What is the purpose of liquidity and annual audit for a company that is surrendering its license?

Liang stated an escrow license is not surrendered until a surrender has been accepted. A licensee is required to comply with the escrow laws and regulations including to meet its financial requirements and to submit an annual audit report. It is not uncommon to see a licensee rescind their request to surrender a license.

Garcia questioned how such requirement will benefit consumer if a licensee does not have the funds to meet its financial requirements or to engage a CPA to do an annual audit. Liang stated maintaining financial requirements and submitting an annual audit mitigate risks to consumer funds. Those requirements may be waived under some circumstances such as when the Department is placing the company under conservatorship or receivership. In those cases, an annual audit report may not be necessary.

- 5) Can an escrow agent pay broker's commission to a third party who is not a DRE licensee?

Liang stated real estate brokers are not considered principals to the real estate transaction. Escrow regulation clarifies the principals to the transaction are the buyer and seller or the borrower and lender. Licensees should follow principals' instructions. If a seller authorizes the escrow agent to pay commission to a broker, an escrow agent should follow that instruction. A broker's Commission Disbursement Authorization is not considered a principal instruction under the escrow regulation.

Garcia commented that the problem to say no to CDA is to give a competitive advantage to DRE broker-controlled escrow companies or title-controlled escrow companies that will say yes. Liang stated the Department observed in recent years real estate brokers used escrow agents as

bookkeeper to manage their earned commissions and use those funds to pay their personal and business expenses such as to pay referral fees to a different broker, paying college tuitions, personal credit card payment, car payment, child support, alimony, etc. Liang reminded licensees that providing this type of service to the real estate brokers is beyond the scope of an escrow agent's escrow practice, and it may provide a thing of value to the brokers in violation of the referral fee provision in the escrow law.

Juliana Tu commented that education and enforcement should be coming from DRE because in broker's mind, escrow agents are bidding for transactions. If an escrow agent does not provide such service, they will find someone else who will. Garcia commented that it's a very difficult business decision to make. Theoretically it is an independent escrow agent's practice and procedure, but the company is still competing with broker-controlled escrow companies and those independent escrow companies owned by a brokerage firm. Griffin cautioned there might be something a licensee is not aware of when a broker is asking the licensee to pay their commission to parties unknown to the escrow transaction. A licensee will not know if a broker is trying to hide commission from a partner, spouse, or creditors. A licensee may be dragged into a divorce or business dissolution because the licensee has been funding broker's expenses. Griffin recommended licensees to be aware of the general DRE issues to forearm themselves.

- 6) Can licensee retain an e-signature consent form electronically.

Liang stated a licensee may retain records electronically by following the guidance in escrow regulations. A prior escrow bulletin has already clarified that a copy of the electronic consent form should be maintained in the escrow file. Advisory members discussed risks in accepting electronically signed documents.

4. Insured Cash Sweep Program

Liang stated the DFPI received multiple inquiries regarding an ICS program which has been promoted to the independent escrow industry after a recent bank run. Banks that promoted this program asserted the program would avoid the FDIC insured limit by depositing funds into a network of FDIC insured banks to provide unlimited coverage. Liang stated whether this ICS program may cause violations of the escrow law would need to be reviewed in an actual arrangement.

There are specific requirements in the escrow law for maintaining a trust account. A trust account should be a non-interest bearing account, be designated as trust or escrow account, and the account should be in California for those who are members of EAFC. If any of the accounts in the network of ICS banks are not meeting those requirements, there may be a violation of the escrow law. Liang also stated it is unclear how trust account bank reconciliation could be done if licensee is only receiving one consolidated trust account bank statement for all banks which hold trust funds.

Patrick Felde commented that this ICS is not a typical sweep where funds are swept from one bank account to another within the same financial institution, i.e. one that automatically swept all incoming funds to a main trust account to camouflage the identity of a trust account so people cannot hack into it. Felde hasn't seen this type of ICS arrangement in recent audits. Felde shared when the FDIC took over Guardian bank, customers who have more than \$250,000 will get that amount immediately or have access to \$250,000. After the FDIC did their accounting, maybe after several months later, the customer will get another \$250,000; and after a year later, the customer will get another \$250,000. Eventually everybody got all their money out of Guardian Bank, but it took about two years. Felde stated licensees can protect themselves by reviewing a bank's annual audited financial statements

including balance sheet, income statement, statement of cash flow, and also statement of other comprehensive income. Knowing licensee's bank is a way to protect the trust account.

Cassel stated licensees are being asked because it is the clientele that is bringing in cash and the properties are in the millions. The client is depositing a huge amount of funds with the licensee, and they ask who you bank with. Cassel stated it would be very concerning if a licensee does not know where the trust funds go in the ICS network.

5. Examination Updates and scams

Suzuki shared some recent examination findings to remind licensees to be vigilant. In a recent case, a licensee processed a vacant land transaction where the sellers were a traveling couple. The licensee communicated with the sellers verbally and electronically. The licensee had the seller's signed and notarized wire instructions. The transaction was recorded, and proceeds were wired. The licensee also mailed the final closing statement to the sellers. The wire was rejected by the receiving bank because the beneficiaries on the wire were different from the name of the account holder. The vacant landowner received the final closing statement and contacted the licensee that they had no knowledge of this sale. It appears a fraudster impersonated sellers to sell the property. The Department is still reviewing this matter but wants to share this information with the industry to make the industry aware of similar scams. There has been an uptick in vacant property scams in recent years.

Another recent scam involved social engineering where a fraudster gained access to a licensee's banking system by posing as a bank representative to inform licensee that they were performing data migration. They told the licensee to log into their online banking account and requested licensee to input their security code and stayed logged in for about two hours until the data migration is completed. During this time, licensee experienced connectivity problems to their network and the scammer gained access to their trust and general accounts and wired all their funds out to various bank accounts. This is a tragic situation. Suzuki reminded licensees to be aware and vigilant that bank employees will not call or text customers out of blue. A safe thing to do when getting a call from someone who claims to be a bank representative is to hang up the call, dial the bank's number on the bank statement, and ask to speak to a representative. Licensees who have a rapid response plan for wire fraud tends to react and recover quickly.

In another case, an escrow manager made unauthorized disbursements to themselves for notary fees when there wasn't any notary service provided. This manager also cancelled outstanding checks and issued funds to payees for the benefit of the escrow manager. Licensees should invoke good internal controls and be diligent in auditing escrow files and reviewing escrow ledgers for both open and close escrow files for this type of scenario. During tough economic times people can be desperate, also fraudsters are no longer naïve about escrow processes. They know the detailed processes.

Felde question in the second case if the bank was able to institute any loss recovery protocols to pull back those wires sent by the scammer. Suzuki stated yes. Some but not all funds were recovered. Tu shared a recent vacant land escrow transaction she rejected because it seemed suspicious.

6. Escrow Advisory Committee Openings

Liang stated the advisory committee had one opening for a representative of other business ownership. This position has been vacant since the last advisory member retired last year. There will be three opening positions on the advisory committee for an attorney, a representative for medium sized escrow company, and a representative for company with a business specialization. Liang encouraged current advisory members and those who are willing to serve to apply for these positions.

7. Ad Hoc Committee progress

Garcia provided an update about the ad hoc committee for remote work and audit procedures. Ad Hoc committees met recently and worked on both matters. On the remote work committee, members mainly focused on the type of controls as far as distribution of funds needs to be under a brick-and-mortar location.

8. Enforcement Actions and Licensing Update

Liang provided an update about enforcement actions during the second quarter including one accusation to bar a person for making unauthorized disbursements, settling a case with a licensee that had trust account shortage, and settling a case with a licensee with repeated financial deficiencies, etc.

Liang also provided an update about licensing stats. As of April 30, 2023, there were 727 licensed escrow companies at 1,078 licensed locations. The number of licensed companies increased by eight from the same period a year ago. The number of licensed locations increased by 20 from the same period a year ago. The number of licensed companies and licensed locations continued to trend upward. As of June 2, 2023, there were 29 licenses pending surrender and 42 license applications pending approval.

9. Public comments

Members of the public discussed the interest rate hikes and how they impacted the industry. Advisory members asked if the Commissioner would be able to attend the next advisory meeting. Members are open to attend an in-person meeting with the commissioner in Northern California if it can be arranged. Liang stated he will reach out to the Commissioner's assistance to make the inquiry.

10. Closing remarks

Liang thanked everyone for their attendance and participation. The next meeting is scheduled for September 12, 2023, from 10:00 a.m. to noon at DFPI Los Angeles office. Meeting announcement will be posted on the department's website. At about 12:25 p.m., the meeting adjourned.