

FINAL STATEMENT OF REASONS  
FOR RULE CHANGES UNDER THE  
ESCROW LAW

As required by Section 11346.2 of the Government Code, the California Corporations Commissioner ("Commissioner") sets forth below the reasons for the proposed amendments to Sections 1710, 1717.2, 1726, 1730, 1732.2, 1737, 1737.1 (renumbered as 1737.3), 1738, 1738.2, 1738.3, 1738.5, 1740.1, 1740.4, 1741.1 and 1741.3 and proposed adoption of Sections 1709.1, 1717.2, 1730.1, 1737.1, 1737.2 and 1738.6, of the California Code of Regulations (10 C.C.R. Secs. 1709.1, 1710, 1717.2, 1726, 1730, 1730.1, 1732.2, 1737, 1737.1, 1737.2, 1737.3, 1738, 1738.2, 1738.3, 1738.5, 1738.6, 1740.1, 1740.4, 1741.1 and 1741.3).

Over the last couple of years, the California Legislature enacted several bills that amended the Escrow Law (Financial Code Section 17000, et. seq.) to recognize and accommodate the new business of performing escrow transactions over the Internet by companies now labeled as Internet escrow agents. The bills are Assembly Bill 583 (Chapter 441, Statutes of 1999), Assembly Bill 410 (Chapter 253, Statutes of 1999), and Assembly Bill 333 (Chapter 437, Statutes of 2000).

AB 583 amended the Escrow Law to recognize and encompass the performance of escrow agent services over the Internet, including the recognition of, and the addition of a definition for, "Internet escrow agent," the recognition of electronic communications, and the transmission of escrow instructions electronically.

AB 410 amended the Escrow Law to limit the membership requirement for escrow agents with, and indemnity coverage by, Escrow Agents' Fidelity Corporation ("EAFC") to those licensees engaged in the business of receiving escrows in certain listed types of transactions. The bill limits EAFC's coverage to loss of trust obligations with respect to those listed types of transactions and requires escrow agents to obtain separate fidelity bond coverage for all other types of transactions, such as personal property transactions performed by Internet escrow agents. The bill also requires members of EAFC who engage in both listed and non-listed types of transactions to maintain separate books and records of account and separate trust accounts.

AB 333 amended the Escrow Law to expand the definition of escrow transactions conducted by Internet escrow agents to include those taking place on the Internet for the sale or transfer of personal property or other services. AB 333 permits Internet escrow agents to use Internet-authorized payment alternatives and substitutes electronic transfers (such as wire transfers) for traditional account transfers. The bill also allows Internet escrow agents to maintain all records required under the Escrow Law electronically and to provide those records to the Commissioner in electronic format. Furthermore, the bill allows an Internet escrow agent to establish a customer

contact center that is not required to be licensed as a branch office nor staffed by a qualified person provided the location is used solely for the purpose of responding to customer electronic messages and telephone inquiries. Finally, the bill requires that a person possessing knowledge and understanding of the Escrow Law, regulations and accounting shall be on duty at each business location of an Internet escrow agent during business hours.

In general, the Commissioner makes the following changes to the Escrow Law regulations in order to: (1) conform the rules to the changes made in the law as a result of the enactment of AB 583, AB 410 and AB 333; (2) eliminate any inconsistencies between the law and the regulations resulting from the enactment of these bills; and (3) continue to ensure that adequate protection is provided to the public that uses the services of escrow agents, including Internet escrow agents.

Section 1709.1: Financial Code Section 17005.3 (second of two) provides a definition for “customer contact center,” which allows an Internet escrow agent to establish a customer contact center that is not required to be licensed as a branch office pursuant to Financial Code Section 17213.5, if it is used solely for the purpose of responding to customer electronic messages and telephone inquires. The Commissioner is adopting Section 1709.1 to require Internet escrow agents to notify the Commissioner of the business location of customer contact centers at least 10 days prior to commencing business activity, and to notify the Commissioner at least 10 days prior to the change in address of a customer contact center. This will allow the Commissioner to monitor the activities of customer contact centers to ensure the business conducted at the location does not exceed that which is allowed by Financial Code Section 17005.3.

Section 1710: Section 1710 provides that all of the Escrow Law regulations are applicable to joint control agents as described in Financial Code Section 17005.1 and that all references in the regulations to “escrow agent” shall be deemed to refer to joint control agents. The Commissioner amends this section to provide that the Escrow Law regulations are also applicable to Internet escrow agents as described in Financial Code Section 17004.5 and that the references in the regulations to “escrow agents” shall also be deemed to refer to Internet escrow agents. This would clarify that the regulations pertain to Internet escrow agents as well as joint control agents.

Section 1717.2: Financial Code Section 17200.8(b) requires that within the organization of each Internet escrow agent corporation engaged in the business of escrows involving personal property, one or more qualified persons shall demonstrate knowledge and understanding of the Escrow Law (as set forth in Division 6 (commencing with Section 17000)), the rules promulgated thereunder and accounting practices and procedures. The Commissioner adopts Section 1717.2 to clarify the experience requirement for Internet escrow agents in order to comply with Financial Code Section 17200.8(b). New Section 1717.2 would set forth the requirements that a person would need to meet in order to be a “qualified person” for purposes of Financial Code Section 17200.8(b), as follows:

- (a) Execute an affidavit certifying under penalty of perjury that the person has read and understood the provisions of the Escrow Law and the regulations promulgated under the Escrow Law; and
- (b) Possess a minimum of two years of experience performing and/or supervising accounting functions that are similar to those functions that will be necessary to maintain the books, records and accounts of the Internet escrow agent as required by the Escrow Law and its rules; or
- (c) Successful completion of beginning and intermediate accounting courses or equivalent accounting courses with a grade of “C” or better from an accredited college. College transcripts shall be provided to the Commissioner to demonstrate this requirement has been met.

This change is necessary to set forth the requirements that a person would need to meet in order to demonstrate knowledge and understanding of the Escrow Law and the rules promulgated thereunder and accounting practices and procedures in order to comply with Financial Code Section 17200.8(b).

Section 1726: Section 1726 requires EAFC to notify the Commissioner that an escrow agent has paid the required membership fees. This section also requires the escrow agent to notify the Commissioner, on the form prescribed, of the names of any officer, director, trustee, employee, or other person directly or indirectly compensated by the escrow agent and to file fingerprint cards for those individuals that are not already on file with the Commissioner. The Commissioner amends this section to require EAFC to notify the Commissioner that the membership fees have been paid only for those escrow agents that are required to be members of EAFC as provided for in Financial Code Section 17312(a) and (c). This change is necessary to conform this rule to the changes made by AB 410.

The Commissioner also amends this section to allow an escrow agent to file with the Commissioner a “Request for Live Scan Service” instead of a fingerprint card. The Department of Justice developed a program that allows applicants to submit fingerprints electronically using live scan technology. Currently, Section 1726(d) provides that the escrow agent shall provide a fingerprint card to the Commissioner. This change will allow the escrow agent to submit fingerprints using a fingerprint card or a live scan form.

Section 1730: Section 1730 currently requires that the escrow agent maintain its books, records and accounts in the State of California and requires that the escrow agent notify the Commissioner in writing of the location of the books and records. This section also requires that the escrow agent notify the Commissioner 15 days prior to changing the location of such books. The Commissioner amends Section 1730 to require that the escrow agents who are engaged in the business of receiving escrows specified in Financial Code Section 17312(c) and are required to be members of EAFC shall have their business offices located in California and maintain their books, records and accounts

in the State of California. Those escrow agents that are not engaged in the business of receiving escrows specified in Financial Code Section 17312(c) and are not required to be members of EAFC (e.g., Internet escrow agents) shall be allowed to maintain their books, records and accounts in the State of California or in the state they are located in.

Currently, all escrow agents are required to maintain their books, records and accounts in the State of California. AB 583 added Financial Code Section 17005.5 to clarify that any person located outside of California that offers or provides escrow services to persons inside California is subject to the California Escrow Law. This change was mainly made to address the way Internet escrow agents conduct business. Internet escrow agents can be located almost anywhere since they conduct all of their business over the Internet and have no face to face contact with their customers. Furthermore, since Internet escrow agents deal exclusively in personal property transactions, they are not required to become members of EAFC and are required to obtain separate fidelity bond coverage in order to protect the trust funds of their customers. The Department of Corporations has concluded that because of the statutes in the Escrow Law relating to EAFC and to escrow agents required to be members of EAFC, the Department would not be able to issue licenses to escrow agents that would be required to be members of EAFC and are located outside of California. Thus, this change to Section 1730 would clarify that those escrow agents that are not required to be members of EAFC, such as Internet escrow agents, to maintain their books, records and accounts in California or in the state they are located in while those escrow agents that are required to be members of EAFC shall be required to maintain their books, records and accounts in California.

Section 1730.1: Financial Code Section 17405 requires the Commissioner to conduct a routine regulatory examination of every escrow agent at least once every four years and authorizes the Commissioner to conduct other nonroutine inspections and examinations at any time. Financial Code Section 17405.1 requires that the escrow agent shall pay for the cost of every inspection and examination. Financial Code Section 17209 provides that the application for an escrow agent's license may include other items required by the Commissioner. The Commissioner adopts Section 1730.1 to provide that a license for a business located outside this state may be issued only to those escrow agents that are not engaged in the business of receiving escrows specified in Financial Code Section 17312(c) and are not required to be members of EAFC if the escrow agent agrees in writing in the license application to pay the reasonable expenses for travel, meals and lodging of the Commissioner or the Commissioner's representatives incurred during any investigation or examination made at the escrow agent's location outside this state. This will allow the Commissioner to issue a license to escrow agents located outside California that are not required to be members of EAFC, such as Internet escrow agents, and will allow the Commissioner to recover the expenses incurred in performing investigations and examinations of those out of state locations.

Section 1732.2: Section 1732.2 currently requires that an escrow agent shall maintain certain books and records. Financial Code Section 17409 requires that those escrow agents engaged in both types of transactions, i.e., those transactions specified in

Financial Code Section 17312(c) and those not specified, to maintain separate escrow or trust bank accounts for both types of business. The Commissioner amends Section 1732.2 to require an escrow agent engaged in both types of transactions to maintain separate books and separate escrow trust accounts for each type of escrow business in the same manner as provided in subsection (a). In addition, the Commissioner amends this section to require that escrow agents located outside the State of California, in addition to these requirements, to maintain separate books, records and escrow trust bank accounts for the escrow activity that occurs within the State of California as defined in Financial Code Section 17005.5. These changes would conform the rule to the new requirements set forth in Financial Code Section 17409, which were intended to keep those transactions covered by EAFC separate from those that are not required to be covered by EAFC. Separate record keeping and separate trust accounts are needed for those transactions not covered by EAFC as an escrow agent would need to obtain separate individual fidelity bond coverage for such transactions through an insurance company.

Section 1737: Section 1737(a) provides that all money received by an escrow agent as part of an escrow transaction shall on or before the close of the next full working day deposit such money in the trust bank account. The Commissioner proposes to amend Section 1737(a) to include an exception for Internet escrow agents as provided under (proposed new) Section 1737.1. See discussion below for proposed new Section 1737.1.

Section 1737(b) makes a reference to the written instructions of the principals to the escrow transaction. The Commissioner amends this subsection to also include a reference to the electronic instructions received by an Internet escrow agent from the principals. AB 583 amended the Escrow Law to allow the use of escrow instructions over the Internet by Internet escrow agents. This change is necessary in order to conform the rules to the changes in the Escrow Law made by AB 583.

Section 1737(i) provides that no electronic fund transfers shall be made between “trust” or “escrow” account and any interest-bearing account. The Commissioner proposes to amend this subsection to provide that an escrow agent may electronically transfer funds between the “trust” or “escrow” account and any interest-bearing account. This is consistent with the provisions of Financial Code Section 17403.5(b), which were added by AB 333, that allow Internet escrow agents to make transfers between such accounts electronically. The change is necessary to conform the rules to the changes in the Escrow Law made by AB 333.

Section 1737(i) further provides that transfers between such accounts shall be made only in a manner consistent with the provisions of Section 1740.4. The Commissioner proposes to delete this provision of Section 1737(i). This change is necessary because Section 1740.4 requires such transfers to be accomplished by the

writing of a check, which is inconsistent with new Financial Code Section 17403.5. Financial Code Section 17403.5 allows Internet escrow agents to make such transfers electronically, without having to write an actual check.

Section 1737.1 (New): The Commissioner adds Section 1737.1 to the regulations to address the use of credit cards and Automated Clearing House ("ACH") deposits by Internet escrow agents and the losses that could result therefrom. First introduced in the early 1970s as a more efficient alternative to checks, ACH has evolved into a nationwide mechanism that processes electronically originated credit and debit transfers from participating institutions nationwide. The Operating Rules of the National Automated Clearing House Association specify the formats for ACH transactions and define the rights, obligations and warranties of the parties involved in ACH transactions.

AB 583 provided that certain escrow transactions may be processed over the Internet. Internet escrow agents that process escrows over the Internet will receive funds by credit card and/or ACH for deposit into the escrows. Pursuant to Escrow Law regulations and sound escrow practice, escrow agents should not close an escrow or make any disbursement from the escrow until "good funds" are on deposit in the escrow trust bank account. Credit card and ACH deposits may not be considered "good funds" for a substantial length of time due to the time the account may be debited for charge backs, disputed charges, fraudulent transactions and other debits. The Commissioner proposes to adopt subsection (a) to provide that an Internet escrow agent shall deposit all money received from a credit card or ACH as part of an escrow transaction into a bank, a savings bank, or a savings and loan association in a separate account that is designated a "trust" or "escrow" account. Those funds received from a credit card or ACH shall not be deposited or otherwise commingled with any other escrow money. This will prevent losses from credit cards and ACH deposits from impacting other trust monies. The Commissioner further adopts subsection (b) to provide that an Internet escrow agent shall not disburse any monies from an escrow where the deposits are received by credit card or ACH until the funds for that transaction have been deposited into the escrow trust bank account.

To address losses that could result from the acceptance of credit cards and ACH deposits, the Commissioner proposes to adopt subsection (c) to require that an Internet escrow agent establish a reserve for credit card and ACH losses in the amount of 10% of the average credit card and ACH receipts. The losses the reserve shall cover includes, but is not limited to, charge backs, disputed charges, fraudulent transactions and any other debits. If actual credit card and ACH losses exceed 10% of average monthly credit card and ACH receipts, the Internet escrow agent shall be required to immediately increase the reserve to equal the percentage of actual credit card and ACH losses to the average monthly credit card and ACH receipts. The Commissioner may approve a lower reserve if, in the opinion of the Commissioner, the lower reserves will be sufficient to cover anticipated credit card and ACH losses. The reserve will be in addition to the liquid asset and tangible net worth requirements of Financial Code Section 17210. In addition, the Commissioner proposes to adopt subsection (d) to provide that an Internet escrow agent shall be required to deposit funds from the reserve into the escrow trust bank

account to cover any credit card and ACH losses on or before the close of the next full working day unless funds for that credit card or ACH deposit remain in the escrow account.

Thus, in general, proposed Section 1737.1 would, for purposes of consumer protection, require Internet escrow agents that accept credit cards and ACH deposits to establish a reserve to cover credit card and ACH losses and to require such Internet escrow agents to replace any losses from credit cards and ACH deposits from the reserve within 24 hours.

Section 1737.2: The Commissioner adds Section 1737.2 to the regulations to address the use of Internet-authorized equivalent of money by Internet escrow agents. AB 333 amended Financial Code Section 17003 to allow Internet escrow agents who are engaged in the business of escrows involving personal property or services to accept the Internet-authorized equivalent of money for the purpose of effecting the sale or transfer of such personal property or services. Pursuant to Escrow Law regulations and sound escrow practice, escrow agents should not close an escrow or make any disbursement from the escrow until "good funds" are on deposit in the escrow trust bank account. It is unknown if the Internet-authorized equivalent of money would meet the requirement that the Internet escrow agent has "good funds" on deposit in the escrow trust bank account. This could subject the Internet escrow agent to the risk of substantial losses.

The Commissioner adopts subsection (a) to provide that an Internet escrow agent shall not disburse any monies from an escrow where the deposits are received from the Internet-authorized equivalent of money until the funds for that transaction have been deposited into the escrow trust bank account. The Commissioner further adopts subsection (b) to provide that an Internet escrow agent who wishes to transact business on a basis other than as provided by this section may request in writing a variance or waiver to the provisions in this section, but may not engage in business in a manner not in compliance with this section without first having received a waiver or variance in writing from the Commissioner. The change is necessary to protect the consumers that use the services of an Internet escrow agent from losses that could result from the acceptance of the Internet-authorized equivalent of money and to conform to Financial Code Section 17003 as amended by AB 333.

Section 1737.1: The Commissioner renumbers Section 1737.1 to 1737.3 and amends this section. AB 333 amended Financial Code Section 17403.5 to provide that Internet escrow agents may maintain all records electronically and may provide those records to the Commissioner in electronic format. Existing Section 1737.1 sets forth the records to be preserved by escrow agents and allows the storage of such records by optical image storage media if certain conditions are met. The Commissioner amends this section to provide that an escrow agent may retain and provide these records in electronic format to the Commissioner provided the following conditions are met:

- (a) The electronic records are maintained and provided in a format that allows the Commissioner complete access to all of the books, accounts and records.

- (b) The electronic records must be provided to the Commissioner in a software format that is acceptable to the Commissioner and that the Commissioner has in his or her possession.
- (c) The escrow agent ensures that the Commissioner has the ability to download and print any or all of the records that are stored and maintained electronically.
- (d) The escrow agent shall provide any or all of the records maintained in electronic format in printed form if the electronic records are not in a format that is acceptable to the Commissioner or upon the request of the Commissioner.
- (e) The electronic records shall be maintained in a media that is (1) non-erasable “write once, read many” (“WORM”) that does not allow changes to the stored document, (2) consistent with the minimum standards of quality approved by either the National Institute of Standards and Technology or the Association for Information and Image Management, and (3) contain written authentication identifying the electronic record as an exact unaltered copy of the document.

Finally, the reference to optical image storage media would be deleted and the proposed changes would apply to all escrow agents. This change is necessary in order to conform the rules to Financial Code Section 17403.5 as amended by AB 333 and provide guidelines for storing records electronically and providing specified records in electronic format to the Commissioner.

Section 1738: Section 1738 requires that all money deposited into an escrow trust account shall be withdrawn, paid out, or transferred to other accounts only in accordance with the written instructions of the principals to the transaction or pursuant to a court of competent jurisdiction. The Commissioner amends this section to also provide that all money deposited into an Internet escrow transaction shall be withdrawn, paid out, or transferred to other accounts only in accordance with instructions that have been electronically transmitted and executed by the principals to the transaction. This change is necessary as AB 583 amended the Escrow Law to allow the use of escrow instructions over the Internet.

The Commissioner also amends this section to provide additional requirements for escrow trust funds wired out of the escrow trust account. The escrow agent would need to comply with the following procedures for wire transfers:

- (a) The instructions authorizing the wire transfer must contain certain specified information.
- (b) The escrow agent must retain confirmation of the wire transfer from the financial institution that contains certain specified information.



- (c) If necessary, the escrow books should be properly adjusted to reflect the wire transfer.
- (d) The escrow agent must maintain a proper audit trail and adequate controls and safeguards for the wire transferred funds.

This change will comply with Section 1732 for wire transfers out of the escrow trust bank account which requires that an escrow agent shall maintain its books, records and accounts in accordance with generally accepted accounting principles and good business practice. The procedures for wire transfers out of the escrow trust bank account requires the escrow agent to establish adequate internal controls to protect against unauthorized wire transfers and maintain an adequate audit trail. Finally, the change will allow escrow agents to establish and utilize current procedures for wire transfers that are efficient and cost effective while maintaining adequate accounting controls and audit trails.

Section 1738.2: Section 1738.2 requires that an escrow agent shall use documents or other property deposited into escrow only in accordance with the written instructions of the principals to the transaction or pursuant to sound escrow practice or pursuant to a court of competent jurisdiction. The Commissioner amends this section to also provide that an escrow agent shall use documents or other property deposited into an Internet escrow transaction only in accordance with instructions that have been electronically transmitted and executed by the principals to the transaction. This change is necessary as AB 583 amended the Escrow Law to allow the use of escrow instructions over the Internet.

Section 1738.3: Section 1738.3 requires that all written escrow instructions shall be dated. The Commissioner amends this section to require that, in addition to the written escrow instructions, all escrow instructions transmitted over the Internet shall be dated. This change is necessary as AB 583 amended the Escrow Law to allow the use of escrow instructions over the Internet.

Section 1738.5: Section 1738.5 provides certain requirements for printed escrow instructions, including the requirement that in order for the instruction to be valid, it must be initialed by the principals to the transaction. The Commissioner amends this section by revising the heading from "Printed Instructions" to "Escrow Instructions" and by providing that instructions are also valid if they are electronically executed by the principals. This change is necessary as AB 583 amended the Escrow Law to allow the use of escrow instructions over the Internet.

Section 1738.6: AB 583, AB 410 and AB 333 allowed Internet escrow agents to process certain types of escrows over the Internet, including the transmission and receipt of escrow instructions and other escrow documents electronically. The Commissioner adds Section 1738.6 to provide that Internet escrow agents may accept escrow instructions that are created, generated, sent, communicated, received or stored by electronic means provided that the principals agree to conduct the transaction

electronically and acknowledge that they are able to electronically receive the escrow instructions and download and print the instructions. If a principal is not able to receive the instructions electronically, the escrow agent shall be required to mail a copy of the instructions within 24 hours of execution. This section would further provide that the principals may execute these escrow instructions with an “electronic signature” that complies with the federal Electronic Signatures in Global and National Commerce Act (the E-Sign Act). These changes would ensure that the principals to the Internet escrow transactions are able to participate in the processing of the transaction over the Internet and receive copies, whether electronically or hard copy, of the escrow instructions. These changes will conform the rules to the changes made in the Escrow Law by AB 583, AB 410, and AB 333 and comply with the federal E-Sign Act.

Section 1740.1: Section 1740.1 requires an escrow agent that has a conflict of interest, such as also being a principal to the escrow transaction, to provide in writing a notice of interest to all parties to the escrow transaction. The Commissioner amends this section to provide that Internet escrow agents may provide the notice of interest electronically over the Internet to all parties to the transaction. This change is necessary as the Escrow Law allows Internet escrow agents to transmit and accept escrow instructions and other escrow documents electronically over the Internet.

Section 1740.4: Section 1740.4 requires transfers between escrows to be accomplished by the actual writing of a check. The Commissioner adds subsection (b) to Section 1740.4 to provide that this section does not apply to Internet escrow agents. This change is necessary because Financial Code Section 17403.5, which was added by AB 333, allows Internet escrow agents to make transfers between escrow accounts electronically, without having to actually write a check.

Section 1741.1: Section 1741.1 currently requires an escrow agent to issue consecutively prenumbered receipts for all escrow money deposited with or mailed to the escrow agent and retain copies of such receipts in a separate file. The Commissioner amends this section to allow an escrow agent to issue consecutively numbered receipts and that the copies shall clearly be identified as a copy. This change is necessary as the use of computer generated, laser printed receipts places an undue burden on the escrow agents to issue prenumbered receipts. Furthermore, prenumbered receipts are not used in many of the new computer systems to generate receipts.

In addition, the Commissioner amends this section to provide that an Internet escrow agent may deliver a copy of the receipt to the parties electronically over the Internet and may retain a copy of the receipt electronically in accordance with the provisions of subsection (b) of Section 1737.2. It would further provide that if a person is not able to electronically receive the receipt, the Internet escrow agent shall mail a copy of the receipt within 24 hours of execution. This change is necessary as the Escrow Law allows the transmission and receipt of escrow documents electronically over the Internet by Internet escrow agents.

Section 1741.3: Section 1741.3 requires every escrow agent to provide to each principal to the escrow transaction a statement of his or her account in writing. The Commissioner proposes to amend this section to allow an Internet escrow agent to transmit the statement of account to the principals to the Internet transaction electronically over the Internet and, in case a principal is unable to receive the statement electronically, to require the Internet escrow agent to mail a copy of the statement within 24 hours of its completion. This change is necessary to conform this rule to Financial Code Section 17403.5, a statute enacted through AB 333, which allows an Internet escrow agent to deliver the statement of account to a customer by electronic mail or via the Internet.

Finally, the Commissioner makes several technical and non-substantive changes to some of the rules.

#### ALTERNATIVES CONSIDERED

No alternative considered by the Department or that otherwise has been identified and brought to the attention of the Department would be more effective in carrying out the purpose for which the action is proposed or would be as effective and less burdensome to affected private persons, or would lessen any adverse impact on small businesses than the adopted regulation.

#### DETERMINATIONS

The Commissioner has determined that the proposed regulatory action does not impose a mandate on local agencies or school districts, which require reimbursement pursuant to Part 7 (commencing with Section 17500) of Division 4 of the Government Code.

Since this proposed regulatory action, for the most part, is intended to bring the rules into conformance with the changes in the Escrow Law relating to Internet escrow agents and resulting from the enactment of AB 583, AB 410 and AB 333, the Department has determination that this action will not have a significant adverse economic impact on business. Furthermore, any new requirements proposed under this action to enhance consumer protection are not determined to have a significant adverse economic impact on business.

#### ADDENDUM REGARDING PUBLIC COMMENTS

No request for hearing was received during the 45-day public comment period which ended on July 29, 2002. No public hearing was scheduled or heard.

#### COMMENTS RECEIVED DURING THE 45-DAY COMMENT PERIOD

COMMENTOR: Keith Bishop, letter dated July 26, 2002. Mr. Bishop's comments together with the Department's responses are summarized below.

I. Section 1709.1 (3 Comments)

COMMENT 1: Section 1709.1 does not satisfy the "authority" standard by requiring a notice filing for customer contact facilities, by enlarging the scope of Financial Code Section 17213.5.

RESPONSE: Financial Code Section 17400 authorizes the Department to adopt rules to implement the Escrow Law, and to define terms. Section 1709.1 defines and clarifies the circumstances under which a customer contact facility is "operated by an Internet escrow agent" within the meaning of Financial Code Section 17005.3. Nevertheless, the Department will add Financial Code Section 17404 to the reference section of the rule's notes to confirm the authority to require a notice. Here, the notice is needed to enable the Department to determine whether the escrow functions performed at the customer contact center comply with the Escrow Law. Since Section 1709.1 is not intended to clarify or make specific the application of section 17213.5, there is no need to address comments concerning the application of the code section

COMMENT 2: Section 1709.1 does not satisfy the "necessity" standard because there is no justification for the proposed rule.

RESPONSE: To further elaborate on the rule's necessity, the Department needs timely notice of the location of any customer contact center. Without advance notice of these locations, the Department may be unable to perform non-routine (emergency) examinations of these locations, as necessary, to ensure compliance with the Escrow Law. Without this rule, the Department will not have an accurate listing of current customer contact locations thereby impeding its ability to respond quickly to customer complaints involving these locations.

COMMENT 3: The Department has not identified cost impacts associated with the notice requirement of Section 1709.1.

RESPONSE: The Department has not identified any cost impact on Internet escrow agents. The notification requirement would result in insignificant staff time to prepare and mail a written notice. By way of example, if it takes 6 minutes for a Secretary earning \$10 per hour to prepare the notice (and mail), the total cost would be little more than one dollar (\$1), plus postage. As indicated in the Notice dated May 30, 2002, the cost impact on representative private persons or business is "minor and insignificant."

II. Section 1717.2 (7 Comments)

COMMENT 1: Section 1717.2(b) violates the "authority" standard because it prescribes an educational standard pursuant to Financial Code Section 17200.8(b).

RESPONSE: Although Section 17200.8(b) provides that subdivision (a) does not apply (which requires a minimum of five year's experience at main and branch offices), nevertheless Section 17200.8(b) still requires at least one qualified person possessing

knowledge and understanding, as specified. Accordingly, the Department is authorized to clarify and make specific these standards.

COMMENT 2: Section 1717.2(a) does not satisfy the "clarity" standard because it refers to an "affidavit" rather than a "declaration."

RESPONSE: The Department concurs with this comment and has revised Section 1717.2 to reflect the suggested terminology.

COMMENT 3: Section 1717.2 does not satisfy the "necessity" standard because there is no justification for the proposed "affidavit."

RESPONSE: To elaborate, the statement is needed to ensure that at least one person is "qualified" to engage in the escrow business. Financial Code Section 17200.8 requires the qualified person to possess knowledge and understanding, this regulation carries out that objective. Also, self-certification helps avoid additional costs or burdens on smaller businesses.

COMMENT 4: The educational requirement of Section 1717.2 does not satisfy the "necessity" standard, because the proposed two-year experience requirement lacks justification.

RESPONSE: In addition to the Statement of Reasons, the Department recognizes the existing minimum of 5 years (at main office) and 4 years (at branch offices), pursuant to Financial Code Section 17200.8. To avoid potential burdens on small businesses, a lesser requirement of 2 years was proposed as a starting point, pending further evaluation of these licensees by the Department. This was reasonable and justified.

COMMENT 5: Section 1717.2(c) does not satisfy the "clarity" standard because it does not specify the meaning of accredited college and the meaning of a passing grade.

RESPONSE: The Department will clarify the Rule's application to include a definition of accredited college, and to allow passing grades when necessary.

COMMENT 6: Requiring transcripts constitutes an invasion of privacy; and it is unclear how notices under Civil Code Section 1798.17 will be provided.

RESPONSE: The Department is unaware of any laws that make the provision of transcripts an invasion of privacy. The Department complies with all state and federal laws governing the handling of personal identifying information. Notice of compliance with Civil Code Section 1798.17 is provided in the Department's license applications.

COMMENT 7: The Department has not identified any cost impact associated with the furnishing of transcripts.

RESPONSE: It is the Department's understanding the initial copies of transcripts

are provide free of charge, with additional copies at minimal cost to the individual (\$1 to \$3). Thus, the Notice correctly indicates the costs to be minor or insignificant.

III. Section 1730 (1 Comment)

COMMENT 1: Section 1730(a) may violate the North American Free Trade Agreement (NAFTA).

RESPONSE: The Department is unaware of any violation of NAFTA, nor does the commenter demonstrate any violation. This comment also appears to be outside the scope of this rulemaking.

IV Section 1737.1 (2 Comments)

COMMENT 1: Section 1737.1 violates the "authority" and "reference" standards because the regulation establishes reserve requirements.

RESPONSE: This rule clarifies and makes specific the manner in which escrow accounts are "maintained" by a licensee under Financial Code Sections 17409, 17410, and 17411. Thus, the Authority and Reference sections are adequate.

COMMENT 2: Section 1737.1 does not satisfy the "necessity" standard because the 10 % reserve requirement lacks justification.

RESPONSE: The 20 % reserve was based on a review of credit card losses sustained by similar companies. Although a much larger (25 %) reserve requirement could be imposed under the rule, the Department has proposed 10% to avoid additional burdens on businesses. The 10% reserve is subject to a higher percentage, as necessary, under the rule.

V. Section 1737.3 (1 Comment)

COMMENT 1: Section 1737.3 does not meet the "clarity" standard because it does not specify what software is "acceptable."

RESPONSE: The Department has clarified what software is acceptable, to provide further clarity.

COMMENTS RECEIVED DURING THE 15-DAY COMMENT PERIOD.

The Department of Corporations received one comment letter from Keith Paul Bishop, dated February 25, 2003. The comments and the Department's responses are summarized below.

COMMENT 1: Section 1709.1 does not meet the reference standard, by referencing Section 17404 of the Financial Code.

RESPONSE: Section 17404 requires escrow agents to keep and use in its business such record, which will enable the Commissioner to determine whether the escrow functions comply with current law. The notification required under Section 1709.1 is a record which enables the Department to locate a customer contact center, including the books and records, maintained at that site for the purpose of ensuring compliance with the Escrow Law. Nevertheless, the Department will add a reference to Financial Code Section 17406, as well. Section 17406 requires a licensed escrow agent to make "special reports" to the Commissioner and this notice is such a report.

COMMENT 2. Section 1717.2 does not identify any technical, theoretical, and empirical study or report upon which the Department relied in clarifying the term "accredited."

RESPONSE: The Department did not rely on any report or study in clarifying the meaning of "accredited." Instead, the Department is relying on its experience in reviewing the educational background of escrow managers. Experience has shown that escrow managers attend courses on California escrow practice at colleges and universities located in this state.

COMMENT 3: Section 1726 does not include a notice required under Civil Code Section 1798.17 .

RESPONSE: Civil Code Section 1798.17 presently requires a notice of specified information. It is the Department's practice to include such a notice in all of its applications. There is no statutory requirement for adopting this notice as a regulation.

There were no other comments received during the 15-day comment period, which ended on February 28, 2003.

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