

## Senate Bill No. 1604

### CHAPTER 285

An act to amend Sections 17312, 17331.2, 17406, and 17409 of the Financial Code, relating to escrow agents.

[Approved by Governor September 25, 2008. Filed with  
Secretary of State September 25, 2008.]

#### LEGISLATIVE COUNSEL'S DIGEST

SB 1604, Machado. Escrow Agents' Fidelity Corporation.

Existing law, the Escrow Law, provides for licensure and regulation by the Commissioner of Corporations of persons engaged in business as escrow agents, unless specifically exempted. Existing law requires persons licensed as escrow agents to be members of the Escrow Agents' Fidelity Corporation (Fidelity Corporation), which is established as a nonprofit corporation to indemnify its members against loss, and which is funded by fees and assessments on its members. Existing law limits the coverage provided by Fidelity Corporation to certain types of transactions and provides that indemnity coverage for other transactions be provided by escrow agents through bonding requirements.

This bill would require any private insurance coverage of a member, that also covers a loss that would be covered by Fidelity Corporation, to be applied as primary coverage.

Existing law requires employees of escrow agents and various other persons to obtain a certificate from Fidelity Corporation as a condition of employment or compensation. Existing law requires Fidelity Corporation to deny an application for a certificate or to revoke the certificate under certain circumstances.

This bill would allow a person whose certificate application has been denied or whose certificate has been revoked to file a reapplication for a certificate after a specified time, provided that the person has satisfied all obligations to Fidelity Corporation under any prior arbitration award or judgment.

Existing law requires a licensee under the Escrow Law to submit an annual audit report to the commissioner as well as various other financial reports that the commissioner may require. Existing law requires an independent accountant who prepares certain reports in that regard to provide copies directly to the commissioner.

This bill would require a licensee who engages an independent accountant or 3rd-party contractor to reconcile trust account records to request that accountant or 3rd-party contractor to immediately notify the commissioner and Fidelity Corporation upon the occurrence of various events or discoveries.

Existing law specifies the types of financial institution accounts that are allowable depositories for moneys deposited in escrow with a licensee.

This bill would require that an agreement by a licensee with a financial institution to establish a trust account be accompanied by a letter from the licensee authorizing and requesting the financial institution to immediately notify the commissioner and Fidelity Corporation of account closure or the occurrence of an overdraft balance under specified circumstances.

*The people of the State of California do enact as follows:*

SECTION 1. Section 17312 of the Financial Code is amended to read:

17312. (a) Each person licensed pursuant to this division who is engaged in the business of receiving escrows specified in subdivision (c) and whose escrow business location is located within the State of California shall participate as a member in Fidelity Corporation in accordance with this chapter and rules established by the board of directors of Fidelity Corporation. Fidelity Corporation shall not deny membership to any escrow agent holding a valid unrevoked license under the Escrow Law who is required to be a member under this subdivision.

(b) Upon filing a new application for licensure as required by Section 17201, persons required to be a member of Fidelity Corporation shall file a copy thereof concurrently with Fidelity Corporation. If an application for licensure submitted to Fidelity Corporation contains personal or confidential information, Fidelity Corporation and its board shall maintain this information in confidence to protect the privacy of the information. The copy of the application shall include the three thousand dollar (\$3,000) fee specified in subdivision (a) of Section 17320 and all required Fidelity Corporation Certificates set forth in Sections 17331 and 17331.1. Fidelity Corporation shall promptly furnish to the commissioner a compliance letter confirming that the applicant has satisfied the requirements to be a member of Fidelity Corporation.

(c) The required membership in Fidelity Corporation shall be limited to those licensees whose escrow business location is located within the State of California and who engage, in whole or in part, in the business of receiving escrows for deposit or delivery in the following types of transactions:

(1) Real property escrows, including, but not limited to, the sale, encumbrance, lease, exchange, or transfer of title, and loans or other obligations to be secured by a lien upon real property.

(2) Bulk sale escrows, including, but not limited to, the sale or transfer of title to a business entity and the transfer of liquor licenses or other types of business licenses or permits.

(3) Fund or joint control escrows, including, but not limited to, transactions specified in Section 17005.1, and contracts specified in Section 10263 of the Public Contract Code.

(4) The sale, transfer of title, or refinance escrows for manufactured homes or mobilehomes.

(5) Reservation deposits required under Article 2 (commencing with Section 11010) of Chapter 1 of Part 2 of Division 4 of the Business and Professions Code or by regulation of the Department of Real Estate to be held in an escrow account.

(6) Escrows for sale, transfer, modification, assignment, or hypothecation of promissory notes secured by deeds of trust.

(d) Coverage required to be provided by Fidelity Corporation under this chapter shall be provided to members only for loss of trust obligations with respect to those types of transactions specified in subdivision (c). If a loss covered by Fidelity Corporation is also covered by a member's general liability, dishonesty, or indemnity policy, or other private insurance policy, then the member's private policy shall first be applied as the primary indemnity to cover the loss. However, the failure of the member's private primary policy to indemnify the member's loss within the time specified for Fidelity Corporation indemnity in subdivision (a) of Section 17314 shall not limit the indemnity obligations of Fidelity Corporation as defined in this chapter. Indemnity coverage for those types of transactions not specified in subdivision (c) shall be provided by escrow agents in accordance with Section 17203.1.

SEC. 2. Section 17331.2 of the Financial Code is amended to read:

17331.2. (a) Fidelity Corporation shall deny the application for a certificate or revoke the certificate of any person, upon any of the following grounds:

(1) The application contains a material misrepresentation of fact or fails to disclose a material fact so as to render the application false or misleading, or if any fact or condition exists which, if it had existed at the time of the original application for a certificate, reasonably would have warranted Fidelity Corporation to refuse originally to issue that certificate.

(2) That the person has been convicted of a crime or offense, whether a felony, an offense punishable as a felony, or a misdemeanor, that involved dishonesty, fraud, deceit, embezzlement, fraudulent conversion, misappropriation of property, or any other crime reasonably related to the qualifications, functions, or duties of a person engaged in business in accordance with this division. A conviction within the meaning of this section is a plea or verdict of guilty or a conviction following a plea of nolo contendere. A conviction also includes an order granting probation and suspending the imposition of sentence, notwithstanding a subsequent order pursuant to Section 1203.4 or 1203.4a of the Penal Code permitting the person to withdraw his or her plea of guilty and to enter a plea of not guilty, or setting aside the verdict of guilty, or dismissing the accusation, information, or indictment. If, however, the conviction is more than 10 years old, or the conviction has been expunged, or the person has obtained a certificate of rehabilitation or relief under Section 1203.4 or 1203.4a of the Penal Code, or if the conviction was an infraction, then the person may have a Fidelity Corporation certificate upon showing by clear and convincing

proof to a reasonable certainty that the conviction is no longer reasonably related to the qualifications, functions, or duties of a person engaged in business in accordance with this division or that person's employment with a member.

(3) That the person has been held liable in a civil action by final judgment of any court if the judgment involved dishonesty, fraud, deceit, embezzlement, fraudulent conversion, or misappropriation of property or the person has been ordered to make restitution to a victim in any criminal case involving a crime or offense set forth in paragraph (2). The person may have a Fidelity Corporation certificate upon showing by clear and convincing proof to a reasonable certainty that the judgment or restitution order is no longer reasonably related to the qualifications, functions, or duties of a person engaged in business in accordance with this division or that person's employment with a member.

(4) That the person has (A) committed or caused to be committed an act which caused any member to suffer a loss; (B) committed or caused to be committed or colluded with any other person committing any act which caused a loss, for which Fidelity Corporation or the insurer on any insurance policy or fidelity bond purchased by Fidelity Corporation, or both, to become liable to indemnify any member; or (C) committed or caused to be committed an act of dishonesty, fraud, deceit, embezzlement, fraudulent conversion, or misappropriation of property, to the material damage of a member or for which the member has been held liable to any third party, by final judgment.

(5) That the person has been barred from employment by final order of the commissioner pursuant to Section 17423.

(6) That the person has been deemed not qualified to serve in any capacity as a director or officer or in any other position involving management duties with a financial institution, pursuant to Division 1.8 (commencing with Section 4990).

(7) That the person has been denied coverage or reinstatement by any insurer under any fidelity bond or crime policy, unless a decision of reinstatement of coverage has been made after that denial. A person who obtained a decision of reinstatement of coverage prior to the effective date of this section may have a Fidelity Corporation certificate notwithstanding paragraphs (2) and (3), unless any other ground for denial or revocation applies to that person.

(b) Fidelity Corporation shall suspend the certificate of any person upon either of the following grounds:

(1) That the person has been censured or suspended from any position of employment by final order of the commissioner. The certificate suspension shall be for a term concurrent with the final order of the commissioner.

(2) That the person has been barred from any position of employment or management or control of any escrow agent, for a term of less than permanent, by final order of the commissioner. The certificate suspension shall be for a term concurrent with the final order of the commissioner.

(c) Fidelity Corporation may suspend the certificate of any person under either of the following grounds:

(1) That there is an action commenced by the commissioner to either suspend or bar that person, under Section 17423.

(2) That any member with whom the person was employed has given a proof of loss or a notice of an occurrence which may give rise to a claim for a loss of trust obligations either of which identifies the person as the person responsible for the loss or as a person acting in collusion with the person causing the loss.

(d) Upon denial of an application for, or upon suspension or revocation of the certificate of any person, Fidelity Corporation shall provide written notice to the member with whom that person is employed of the decision, pending any appeal therefrom which might be made. Thereafter, the member shall not allow that person to have access to money or negotiable instruments or securities belonging to or in the possession of the escrow agent, or to draw checks upon the escrow agent or the trust accounts of the escrow agent, but that person may otherwise continue in the performance and discharge of other duties of an employee. Fidelity Corporation shall notify the person in writing of the decision to deny, suspend, or revoke the certificate and of the person's right of appeal, together with the notice of appeal. The grounds and basis for the decision shall be stated in the notice thereof. All notices may be served either personally or by mail, properly addressed to the address of record for the member and the person.

(e) Any person whose application for a certificate has been denied, or whose certificate has been suspended or revoked, may appeal the decision, as provided in Section 17331.3. While that appeal is pending, the person may not have access to money or negotiable instruments or securities belonging to or in the possession of the escrow agent, or to draw checks upon the escrow agent or the trust accounts of the escrow agent, but that person may otherwise continue in the performance and discharge of other duties of an employee pending final decision of that person's appeal. Failure to remove the person whose application has been denied, or whose certificate has been suspended or revoked, as a signer on the trust accounts may be subject to action by the commissioner as provided for in this division and shall be subject to penalties as set forth in Section 17331.1.

(f) Upon expiration of the time for an appeal, or upon conclusion of the appeal, the decision to deny an application for or to suspend or revoke the certificate of any person shall become final. Fidelity Corporation shall give written notice to the member and to the person of the final decision within 10 days. Thereafter, Fidelity Corporation shall disclose in writing to all members the identity of persons whose application has been denied or whose certificate has been revoked. The person whose certificate has been denied or revoked may file a certificate reapplication after the period of time specified in Section 11522 of the Government Code, dating from the Fidelity Corporation final decision, provided that the person has satisfied all obligations to Fidelity Corporation under any prior arbitration award or judgment.

SEC. 3. Section 17406 of the Financial Code is amended to read:

17406. (a) Each licensee shall submit to the commissioner, at the licensee's own expense, an audit report containing audited financial statements covering the calendar year or, if the licensee has an established fiscal year, then for that fiscal year, within 105 days after the close of the calendar or fiscal year, as applicable. At that time, each licensee shall also file additional relevant information as the commissioner may require.

(b) Within 30 days after receipt of a request from the commissioner, a licensee or other person subject to this division shall submit to the commissioner, at the person's own expense, an audit report containing audited financial statements covering the 12 calendar months next preceding the month of receipt of the request, or for another period as the commissioner may require. Unless the public interest shall otherwise require, the commissioner shall exempt a licensee from the provisions of subdivision (a) in whole or in part if the licensee has complied with a request pursuant to this subdivision as of a date within the calendar or fiscal year for which the exemption is granted.

(c) A licensee whose license has been revoked shall submit to the commissioner, at its own expense, on or before 105 days after the effective date of the revocation, a closing audit report as of that effective date, or for another period as the commissioner may specify. The report shall include the information specified by the commissioner. A licensee who has complied with this subdivision is exempt from subdivision (a) of this section.

(d) The reports and financial statements referred to in subdivisions (a) and (b) shall include at least a balance sheet and a statement of income for the year ended on the balance sheet date together with other relevant information as the commissioner may require. The reports and financial statements referred to in subdivisions (a), (b), and (c) shall be prepared in accordance with generally accepted accounting principles, and shall be accompanied by a report, certificate, or opinion of, an independent certified public accountant or independent public accountant. The audits shall be conducted in accordance with generally accepted auditing standards and the rules of the commissioner.

(e) A licensee shall make other special reports to the commissioner as the commissioner may from time to time require.

(f) For good cause and upon written request, the commissioner may extend the time for compliance with subdivisions (a) and (b).

(g) A licensee shall, when requested by the commissioner, submit its unaudited financial statements, prepared in accordance with generally accepted accounting principles and consisting of at least a balance sheet and statement of income and expense as of the date and for the period specified by the commissioner. The commissioner may require the submission of these reports on a monthly or other periodic basis.

(h) If the report, certificate, or opinion of the independent accountant referred to in subdivision (d) is in any way qualified, the commissioner may require the licensee to take action as he or she deems appropriate to permit an independent accountant to remove the qualifications from the report, certificate, or opinion.

(i) The commissioner may reject any financial statement, report, certificate, or opinion by notifying the licensee or other person required to make the filing of its rejection and the cause of the rejection. Within 30 days after the receipt of the notice, the licensee or other person shall correct the deficiency and the failure so to do shall be deemed a violation of this division. The commissioner shall retain a copy of all rejected filings.

(j) The commissioner may make rules specifying the form and content of the reports and financial statements referred to in this section, and may require that those reports and financial statements be verified by the licensee in the manner as he or she may prescribe.

(k) Upon completion of the reports and financial statements referred to in subdivisions (a), (b), and (c), the independent accountant shall submit to the commissioner complete copies of the reports and financial statements at the same time that copies of the reports and financial statements are submitted to the licensee.

(l) A licensee who engages an independent accountant or other third-party contractor to reconcile trust account records shall request the independent accountant or third-party contractor, at a minimum, to immediately notify the commissioner and Fidelity Corporation in the event of any of the following:

(1) The termination or voluntary withdrawal of the independent accountant or third-party contractor from the engagement.

(2) The discovery by the independent accountant or third-party contractor of an unreconcilable trust account debit balance. A debit balance exists if an escrow agent withdraws, pays out, or transfers money from an escrow account in excess of the amount to the credit of that account at the time of the withdrawal, payment, or transfer.

(3) The discovery by the independent accountant or third-party contractor that trust account reconciliations have not been performed for two months after the end of any calendar month.

(4) The discovery by the independent accountant or third-party contractor of exception items in trust account exception reports, that remain uncorrected for two months after the end of any calendar month.

Notification pursuant to this subdivision may be accomplished by transmitting to the commissioner and Fidelity Corporation, in either electronic or paper form, copies of trust account reconciliation exception reports. Nothing in this subdivision imposes any duty or obligation on an independent accountant or third-party contractor to Fidelity Corporation, members of Fidelity Corporation, or the commissioner.

(m) Nothing in this section shall be deemed to require a licensee to contract with a third party to reconcile trust account records.

SEC. 4. Section 17409 of the Financial Code is amended to read:

17409. (a) All moneys deposited in escrow to be delivered upon the close of the escrow or upon any other contingency shall be deposited and maintained in a noninterest-bearing demand or checking account in a bank, a state or federal savings bank, or a state or federal savings association or in a noninterest-bearing account subject to immediate withdrawal in an

industrial loan company insured by the Federal Deposit Insurance Corporation and approved to receive those moneys by the commissioner. Thereafter, these moneys may be deposited in an interest-bearing account in a bank, a state or federal savings bank, a state or federal savings association, an industrial loan company approved to receive those moneys by the commissioner, or a state or federal credit union, if the depositor is qualified for membership under the bylaws of that credit union, and the moneys are maintained separate, distinct, and apart from funds belonging to the escrow agent. Those funds, when deposited, are to be designated as “trust funds,” “escrow accounts,” or under some other appropriate name indicating that the funds are not the funds of the escrow agent.

Upon request of the commissioner, a licensee shall furnish to the commissioner an authorization for examination of financial records of any trust funds or escrow accounts, maintained in a financial institution, in accordance with the procedures set forth in Section 7473 of the Government Code.

(b) A licensee engaged in the business of receiving escrows for deposit or delivery of the types specified in subdivision (c) of Section 17312 and of the types not specified therein shall maintain separate escrow trust accounts, for both types of escrow business in the same manner as provided in subdivision (a) of this section and Sections 17409.1, 17410, 17411, and 17411.1.

(c) Any agreement with a financial institution to establish a trust account pursuant to this section shall be accompanied by a letter from the licensee authorizing and requesting that the financial institution immediately notify the commissioner and Fidelity Corporation, in either electronic or paper form, when it becomes aware of either of the following:

(1) The closure of any account subject to this section, other than to transfer the funds to another designated trust account at the same financial institution in the name of the escrow agent or the remittance of the funds to the Controller’s office for escheat purposes.

(2) The occurrence of any overdraft balance in an account subject to this section.

Nothing in this subdivision imposes any duty or obligation on a financial institution to Fidelity Corporation, members of Fidelity Corporation, or the commissioner.