

CALIFORNIA DEPARTMENT OF BUSINESS OVERSIGHT
ADDENDUM TO THE INITIAL STATEMENT OF REASONS
FOR THE RULE CHANGES UNDER THE
ESCROW LAW

The following statements supplement the Initial Statement of Reasons:

The paragraph in the Initial Statement of Reasons explaining the reasons for the adoption of Section 1718.1 in Chapter 3 of Subchapter 9, Article 4 of Title 10 of the California Code of Regulations to incorporate a surety bond form for escrow agents is supplemented by incorporating the following:

Surety Bond Form

The rule adopting the surety bond form is necessary to ensure that the Department obtains information needed to make a determination that an applicant meets the surety bond requirements for licensure under the Escrow Law. Financial Code Section 17202 requires an applicant to provide a satisfactory bond to the Commissioner at the same time it files an application for an escrow agent license. The rule is necessary to provide an applicant notice of its obligation to submit a bond as well as the information the bond must include in order for the Department to make a determination it is satisfactory. Sections 17201 and 17400 expressly authorize the Department to create an application form by regulation, and the surety bond form is located in SECTION II, Item 3, of the application, as EXHIBIT E.

Paragraph 1

The information requested in Paragraph 1 of the proposed bond form includes the name of the principal, also known as the applicant, the name of the surety business, also known as the "Surety," and their respective addresses. Financial Code Section 17202 provides that a bond shall run to the state for the use of the state and for any person who has cause against the obligor of the bond under the Escrow Law. Code of Civil Procedure Section 996.410 provides that a beneficiary may enforce the liability on a bond against both a principal and a surety and Section 996.430 further provides that the liability on a bond may be enforced by civil action. Thus, this information is necessary to enable the Department to obtain identifying information about an applicant, its chosen Surety and the locations of their respective businesses for service purposes.

The paragraph contains information stating the Surety is an admitted surety insurer. Insurance Code Section 700 provides that a surety must obtain a Certificate of Authority in order to be admitted to transact insurance in California. Thus, this information is needed to ensure the Department that the Surety is authorized to transact general surety business in California.

Additionally, the paragraph states the bond can be used for the state and any person(s) who has a cause of action against the applicant. This information is necessary to notify the applicant and the Surety for what purposes the bond may be used, as provided in Financial Code Section 17202.

Lastly, the paragraph requests the total aggregate penal sum of the bond. Financial Code Section 17202 specifies the minimum amount a bond must be in order to be satisfactory to the Commissioner when it is initially filed and annually thereafter. The initial bond must minimally be in the amount of \$25,000 and future bonds must be maintained in amounts designated by Section 17202 based on an escrow agent's "previous year's average annual trust fund obligations." This information is necessary for the Department to determine whether a bond is in an amount that is satisfactory to the Commissioner, as specified in Section 17202.

Paragraph 2

Paragraph 2 states that an applicant has applied to the Commissioner of Business Oversight for a license to engage in business as an escrow agent, and as part of the requirements of licensure under the Escrow Law is required to provide a bond with specified conditions. This paragraph is necessary to acknowledge an applicant's application for a license as an escrow agent and to put an applicant on notice that licensure requires the submission of a surety bond, pursuant to Financial Code Section 17202, which meets the conditions set forth in Section 17203.

Paragraph 3

Paragraph 3 restates the conditions in Financial Code Section 17203 that an applicant and any and all of its agents and employees must agree to comply with in order for its bond to be instated. The Escrow Law requires that a surety bond be conditioned on a licensee: (1) complying with the Escrow Law; (2) appropriately applying all funds it receives; (3) performing all obligations and undertakings required by the Escrow Law; and (4) paying all amounts it may owe to the state or specified person(s) pursuant to the Escrow Law. This information is necessary to give an applicant and/or escrow agent notice of the conditions with which it must agree to comply to have its bond activated.

Paragraph 4

Paragraph 4 is necessary to provide notice to applicants and sureties that the surety bond is subject to specific provisions in the Escrow Law as follows:

Provision 1

Provision 1 states that any person who sustains an injury covered by the bond may bring an action in his or her own name upon the bond for the recovery of damages sustained as a result of the injury, in addition to other remedies. Code of Civil Procedure Section 996.430 provides that the liability on a bond may be enforced by civil action. Additionally, Section 996.460 provides that if a judgment does not exhaust the full amount of a bond it decreases the amount of the bond, but does not discharge the bond. It further provides that the liability on the bond may be enforced thereafter from time to time until the amount of the bond is exhausted. The Escrow Law limits the time frame in which the liability on the bond may be enforced in Section 17205, by prohibiting such actions more than two years from the occurrence of an act or default. This provision is necessary to

inform applicants and sureties about a beneficiary's right to bring an action against a bond and the timeframe during which such actions may be brought.

Provision 2

Provision 2 states that the amount of the total aggregate liability for which a surety is liable is the penal amount of the bond. This is a restatement of Section 996.470 of the Code of Civil Procedure that limits the aggregate liability of a surety to the amount specified in the bond. Specifically, it provides that aggregate liability to all persons for all breaches of the condition(s) of a bond is limited to the amount of the bond, except where a surety makes an advance payment on a final judgment, fails to make payment on a claim or only makes a partial payment on a claim. This Section further provides that if a bond is given in an amount greater than the amount required by statute or otherwise, the liability of the surety on the bond is limited to the amount required by statute or otherwise, unless the amount of the bond has been increased voluntarily or by agreement of the parties to satisfy an objection to the bond made in an action or proceeding. This provision is necessary to clarify that a surety's liability is limited to the amount indicated on the bond form, which is the same as the amount of coverage required for an applicant or escrow agent by the Escrow Law, as set forth in Financial Code Section 17202.

Provision 3

Provision 3 references Code of Civil Procedure Sections 996.320 and 996.330 regarding how a surety may cancel or withdraw a bond and when that resulting cancellation or withdrawal would be considered effective respectively. This information is necessary to let sureties know that they must do in order to cancel or withdraw a bond.

The provision prohibits such actions until a surety provides a 30-day written notice of the action to the Department. This notice is necessary to put the Department on alert that a licensee may be without a license in 30-days and that the licensee may have done something to cause the cancellation or withdrawal. It is necessary to allow time for the Department to communicate with a licensee to encourage it to renew or obtain a new bond before the existing one expires to avoid being in violation of the Escrow Law and having its license suspended, pursuant to Financial Code Section 17423, or revoked, pursuant to Financial Code Section 17608. The notice is also needed to allow time for the Department to investigate why the bond is being cancelled or withdrawn, pursuant to Financial Code Section 17601, in case it was due to a violation of Escrow Law.

The requirement to provide a copy of the notice to the Escrow Agents' Fidelity Corporation (EAFC) is necessary to enable the EAFC to do similar communications and investigatory procedures of escrow agents, pursuant to Financial Code Section 17336, at an earlier time. Since the Section requires EAFC to report the results and recommendations of all of its investigations to the Commissioner, the Department may obtain helpful information from the EAFC. Currently, the EAFC usually receives notice of such actions when the Department serves an escrow agent with an Order to Cease New Business. Enabling the

E AFC to look into pending bond cancellations and withdrawals at an earlier time is necessary to help the Department contain or guard against Escrow Law violations, especially ones that result in trust fund losses.

A non-renewal is essentially treated the same way as a cancellation by the Department. Thus advance notice of a non-renewal would be equally helpful to the Department and the E AFC.

The "Notice of Bond Cancellation" section in the Initial Statement of Reasons contains a more detailed discussion of this provision.

Provision 4

Provision 4 requires an applicant and or a surety of the bond to provide written notice to the Department if either one is served with notice of an action against them under the bond. This notice is required to enable the Department to regulate and enforce Financial Code Section 17206, which (1) authorizes the Commissioner to require the filing of a new bond when an action is commenced on an escrow agent's bond; (2) requires the filing of a new bond upon the recovery of an action on a bond; and (3) provides for suspension or revocation of an escrow agent's license if a new bond is not provided to the department within 10 days of the recovery or notification of the Commissioner. Specifically, the Department must receive immediate notice of actions against sureties and licensees in order to require a licensee to obtain a new bond if there is a recovery on its existing bond. The provision helps ensure that escrow agents have valid bonds in place to protect the state and the public. In order for the state or a member of the public who has been wronged by an escrow agent to collect on a bond, the bond must be valid. Lastly, the provision informs escrow agents where to file new bonds to facilitate their compliance with the bond requirement.

Provision 5

Provision 5 requires written notice to the Department and the Escrow Agents' Fidelity Corporation (E AFC) if a surety receives a claim or makes full or partial payment on a bond. Financial Code Section 17203 relieves a surety of all liability under the bond, in liquidation, if it pays its full amount of liability to the Commissioner, in lieu of the state or persons having a cause of action against the principal. The Code of Civil Procedure Section 996.460 provides that if a judgment does not exhaust the full amount of a bond it decreases the amount of the bond but does not discharge the bond. It provides that the liability on the bond may be enforced thereafter from time to time until the amount of the bond is exhausted. The notice requested regarding the receipt of any claims on the bond is needed to put the Department and E AFC on alert that a payment is pending on the bond and that it may need to be replenished. It is also necessary to provide them an opportunity to check the reason for the claim in case it involved a trust fund issue that needed to be addressed.

As stated above, Financial Code Section 17206 authorizes the Commissioner to require the filing of a new bond when an action is commenced on

an escrow agent's bond; (2) requires the filing of a new bond upon the recovery of an action on a bond; and (3) provides for suspension or revocation of an escrow agent's license if a new bond is not provided to the department within 10 days of the recovery or notification of the Commissioner. Additionally, Section 17202 requires that the penal sum of the bond be in a specified amount. The notice requested regarding payment on a bond is necessary to enable the Department to ensure that an escrow agent has a bond that is in compliance with Escrow Law. The receipt of this information triggers the Department to require as escrow agent to either obtain a new bond, after a payout, as required by Section 17206, or replenish its existing bond. Lastly, the provision informs sureties where to provide such notices.

Signature of Principal

The applicant must agree in writing in the surety bond form to comply with all of its conditions and provisions. This information is necessary for the Department to make a determination that the applicant has filed a satisfactory surety bond for licensure.

Approval by the California State Attorney General

The surety bond form has been reviewed and approved by the California State Attorney General in accordance with the provisions of Government Code Section 11110. The Office of Administrative Law filed the approved surety bond form with the Secretary of State on August 21, 2013 in accordance with the provisions of Government Code Section 11343.8.

Note

This supplement is intended to provide additional information regarding the original proposed text discussed in the Initial Statement of Reasons, as posted during the 45-day comment period. The Department has also proposed changes to the original text that will be made available for review during the same 15-day comment period as the supplement. The 15-day text changes will be addressed in the Final Statement of Reasons.