STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
100 Van Ness Avenue
San Francisco, CA 94102

Bulletin No. 85-6
April 12, 1985

TO: All Title Insurers, Underwritten Title Companies, Controlled Escrow Companies And Other Interested Persons

SUBJECT: Chapter 1004, Statutes of 1984 - Escrow Float Legislation - Amended California Insurance Code Section 12389 And New Insurance Code Sections 12413 and 12413.5

Senate Bill 1550 (Keene), Chapter 1004, Statutes of 1984, which amended Section 12389 of the California Insurance Code and added Sections 12413 and 12413.5 to the California Insurance Code, became effective as law on January 1, 1985. As a result of the new law, all title insurers, underwritten title companies and controlled escrow companies (hereinafter "title entities"), which engage in the business of conducting escrow and subescrow transactions, may be required to substantially alter their business practices relative to the disbursement of escrow funds.

This bulletin's purpose is to address numerous issues with respect to the new law and to emphasize the importance this Department assigns to practices adopted by all title entities relative to achieving strict compliance with the requirements of the law, particularly Sections 12413 and 12413.5. To this end, please be informed that, in the future, audits of title entities conducted by the Department of Insurance will include substantial reviews of title entities' procedures and practices in handling escrow funds for the purpose of determining compliance with the requirements of the law. The intent of Sections 12413 and 12413.5 is to provide maximum assurance to members of the public that their funds will not be placed in jeopardy when entrusted to a title entity in the course of a real estate escrow transaction; we expect that intent to be foremost in the minds of directors, officers and employees of all title entities during the course of any escrow.

Some specific points to bear in mind with respect to the law:

1. The escrow instructions are ultimately controlling and may require all items, regardless of whether they are in-state or out-of-state items, to be available for withdrawal as a matter of right (defined in paragraph No. 4 below) before recordation and any disbursement may be made. "Items" as used in this paragraph and throughout this bulletin is defined in new Section 12413(g) of the California Insurance Code and means "checks (including cashier's checks), negotiable orders of withdrawal, share drafts, traveler's checks, or money orders."

2. The provisions of Sections 12413 and 12413.5 apply to subescrows as well as escrows conducted by title entities.

3. The new law provides that where in-state items are received for a particular escrow account, funds shall not be disbursed from such escrow account until such items have been deposited into such account. Precautions should be taken before disbursing on such deposited items and we recommend that the following procedures be followed to protect yourself as an escrow/subescrow agent:

    a. A financial institution check should be verified with a responsible officer of the drawee institution to assure that no stop payment has been placed on the check; in addition, a confirmation should be obtained that there will not be a stop payment placed on it.

    b. A corporate or personal check may not represent "good funds" until it clears. Thus, if you accept such a check, you should wait until funds are collected before disbursements are made; as an alternative, encourage customers to make arrangements to fund escrows with cashier's checks, certified checks or wire transfers.

4. The new law provides that where out-of-state items are deposited into an escrow, no funds shall be disbursed with respect to such items until the proceeds thereof have become available for withdrawal as a matter of right from the financial institution in which the items were deposited. "Available for withdrawal as a matter of right" means the earlier of when final settlement has occurred or when time periods for availability of funds on deposited items have elapsed. Such time periods, which are commonly known as hold periods, are set forth in regulations which have been issued by the Superintendent of Banks and the Savings and Loan Commissioner and generally range from 8 to 10 business days. Title entities should ascertain the exact time of final settlement for items drawn on specific out-of-state institutions from those financial institutions where escrow accounts are maintained. Please be advised that the final settlement on out-of-state items may occur substantially earlier than the hold periods set forth in the regulations of the Superintendent of Banks and the Savings and Loan Commissioner.

5. Questions have arisen with respect to the applicability of the new law, particularly the hold periods, to certain payment systems operated by major out-of-state financial institutions. According to the Superintendent of Banks' interpretation of his regulation, items from such payment systems may be considered available

as a matter of right on the next business day after their deposit under certain limited conditions. According to Mr. John R. Paulus, Deputy Superintendent of Banks, pursuant to Section 10.190406(a)(3) of Chapter 1, Title 10 of the California Administrative Code:

> "If an insured thrift or an insured bank located in this state draws its checks on an account it maintains in an out-of-state insured bank, such checks would be considered available on the next business day. However, please note that to the extent such checks exceed the provisions of Section 10.190407(a)(6), they would be subject to the policy of the depositary bank."

Section 10.190407(a)(6) reads as follows:

> "(a) The hold periods for items deposited by a depositor in a deposit account at a depositary bank set forth in Sections 10.190405 and 10.190406 of this Chapter shall not apply in the following cases:
> (6) If and to the extent that the items deposited in a deposit account in one business day exceed $2,500."

Since the amount of a lender's funds received and deposited into an escrow would seldom be less than $2,500, it would appear that the policy of a title entity's escrow depositary bank would be determinative of when the proceeds from items from payment systems of out-of-state financial institutions would be available as a matter of right. A title entity accepting such items should obtain a letter (to be retained for Department of Insurance review during examinations) from its depositary bank which clearly states the bank's policy with respect to hold period for such items. Please be advised that the regulations of the Savings and Loan Commissioner do not contain a provision similar to Section 10.190406(a)(3) and, as such, title entities using saving and loan institutions as escrow account depositaries should not necessarily be guided by this paragraph.

6. The law requires that prior to any disbursement of funds from an escrow account, there must be sufficient funds received and deposited into the escrow. The practice of closing an escrow and disbursing with funds which are not available as a matter of right (in the case of out-of-state items) is a violation of the law and may be a rebate pursuant to Section 12404 of the California Insurance Code. The practice of closing an escrow and disbursing with funds still to come from a lender (who requires recording information to be supplied prior to actually drawing its check) is a violation of the law and is a rebate. The penalty for such rebates may be as much as five times the amount of money involved.

7. The new law requires that all drafts, whether drawn on a financial institution located within or outside of California, be sent for collection and cleared funds be received into the escrowholder's trust account prior to recording documents and disbursing funds.

This Department is most concerned that title entities comply with the overall intent of the new law and curb their past abuses with respects to escrow trust accounts. As escrow/subescrow agents, you are fiduciaries to the principals of escrows. You owe the highest degree of care and duty to those who entrust you to handle their escrow transactions. By closing an escrow on "insufficient funds", you may be held to have violated this duty, thus, subjecting your companies to adverse regulatory action and substantial monetary fines as well as potential civil liability.

BRUCE BUNNER
Insurance Commissioner