

INITIAL STATEMENT OF REASONS

PROPOSED AMENDMENT TO TITLE 10, CHAPTER 6

§ 2910, "CRITERIA FOR SUBSTANTIAL RELATIONSHIP" AND

§ 2910.5, "FINANCIAL CRIMES REGULATORY FINDING AND DEFINITION"

This regulation proposal amends Section 2910 and adds Section 2910.5 to the Regulations of the Real Estate Commissioner (California Code of Regulations, Title 10, Chapter 6) ("the Regulations"). This proposal implements and clarifies the requirements of Sections 480 and 481 of the Business and Professions Code ("the Code"), as those sections were amended by AB 2138 (Chiu, Chapter 995, Statutes of 2018), effective July 1, 2020.

PROBLEM STATEMENT

Current statutes: The early portion of the Business and Professions Code ("the Code") sets out general standards for the licensing activities of many California licensing agencies, including the Department of Real Estate ("DRE"). Among these early Code sections, Sections 480, 481, and 490 establish rules regarding licensing agencies' application screening and disciplinary actions.

The existing Section 480(a) empowers a licensing body to deny a license application on the basis of (1) a conviction in the applicant's past, (2) a dishonest, fraudulent, or deceitful act of the applicant, or (3) on a past act of the applicant that would be grounds for license discipline had the applicant been licensed at the time. The section specifies that the crime or act must be, "substantially related to the qualifications, functions, or duties of the business or profession for which the application is made."

The existing Section 481 requires licensing agencies to develop criteria for substantial relationship that are specific to the field of licensure. DRE's Criteria for Substantial Relationship (capitalized when referring to DRE's standard, as opposed to other agencies' corresponding standards) appear in Section 2910 of Title 10 in the California Code of Regulations.

Section 490, which is not amended by AB 2138, empowers a licensing body to suspend or revoke a license where the licensee has been convicted of a substantially related crime.

Current regulations: As noted above, DRE's Criteria for Substantial Relationship appear at Section 2910 of the Regulations. Per the standard appearing in

Section 480, DRE designed the existing criteria to establish whether a type of crime is an offense that is “substantially related to the qualifications, functions, or duties” of a real estate licensee.

DRE also set out Criteria for Rehabilitation in Sections 2911 and 2912 of the Regulations. Section 2911 is relevant where DRE may deny an application for a real estate license based upon a past conviction or license discipline on the applicant's record. Section 2912 is relevant where a current licensee is subject to license discipline, including instances where a licensee is convicted of a substantially related crime.

Both of DRE's present Criteria for Substantial Relationship sections include consideration of the nature and gravity of the offense, and consideration of the time that has elapsed since the commission of the offense.

AB 2138 impact on current Criteria for Substantial Relationship: AB 2138 amended Sections 480 and 481 with the stated goal of limiting licensing agencies' use of past convictions and formal discipline actions to deny a current license application. Among the bill's provisions, AB 2138 amended B&P Section 481 to require three specific items in each licensing body's criteria for substantial relationship that the current DRE Criteria for Substantial Relationship do not *explicitly* include:

- “(1) The nature and gravity of the offense.
- (2) The number of years elapsed since the date of the offense.
- (3) The nature and duties of the profession in which the applicant seeks licensure or in which the licensee is licensed.”

The present Criteria for Substantial Relationship that appear in Section 2910 of the Regulations must be harmonized with AB 2138's amendment of Section 481 of the Code.

AB 2138 also amends Section 480 to impose a seven-year statute of limitations on the use of most criminal convictions for denial of a license application, but exceptions were also included in the bill. One of these, subdivision (a)(1)(B)(vi), empowers DRE to adopt regulations to clarify types of “financial crimes currently classified as a felony that is directly and adversely related to the fiduciary qualifications, functions or duties” of a real estate licensee. Such offenses would be exempt from the seven-year limitation as a basis for denial of a license application.

PURPOSE, BENEFITS, NECESSITY, AND GOALS OF THIS ADOPTION

DRE proposes amendments to Section 2910 and the addition of Section 2910.5 to the Regulations. DRE's purpose is to address the amendments to Sections 480 and 481 of the Code. The proposal is designed to accommodate the specific changes to the licensing standard reflected in AB 2138, while maintaining DRE's "principal responsibility" to protect the public. (Section 10050(b) of the Code.)

As also noted in the Notice for this proposal, the stated goal of AB 2138 was to increase access to licensure for persons with criminal convictions in their background. Although DRE's Criteria for Rehabilitation includes provisions that already encompass much of the scope of the standard set by AB 2138, this proposal will harmonize DRE's Criteria for Substantial Relationship with the new AB 2138 and, prospectively, allow for some issuance of licenses where present law would limit such access. The proposed regulatory amendments and addition will not benefit worker safety or the state's environment.

DRE's proposed amendments begin with changes to accommodate the three items added to Section 481:

- “(1) The nature and gravity of the offense.
- (2) The number of years elapsed since the date of the offense.
- (3) The nature and duties of the profession in which the applicant seeks licensure or in which the licensee is licensed.”

The first two items—nature and gravity of the offense, and number of years elapsed since the offense—compel a change in the application of the Criteria for Substantial Relationship. Presently, any given crime either fits or does not fit the Criteria. The addition of these two new considerations creates a possibility that a crime could fit the described categories of offense, but still be deemed not substantially related because of either the passage of time or nature-and-gravity of the crime, or both. This compels three amendments:

- Amendment of the imperative language in subdivisions (a) and (b), changing “shall” to “may” and changing “is also” to “may also be”.
- Elimination of the present subdivision (c), because the context of the crime is no longer limited to the use stated in that subdivision.
- The addition of the new subdivision (c), explicitly adding consideration of the nature and gravity of the offense, elapsed years since the offense, and the nature and duties of real estate licensure to the Criteria for Substantial Relationship.

For clarity, the new subdivision (c) also includes an explicit statement that both nature and gravity of the crime and the passage of time will continue to be considered when weighing rehabilitation. The statute does not prohibit the use of these considerations in the rehabilitation context, and they are more relevant to the rehabilitation assessment than they are in the substantial relationship assessment.

The third item among those specified in the new Section 480 requires expression that the Criteria of Substantial Relationship take into account the nature and duties of real estate practice. DRE did take the nature and duties of real estate practice into account when developing the existing Criteria for Substantial Relationship. The types of crimes listed in the existing Criteria for Substantial Relationship strongly reflect the financial/fiduciary aspects of the activities of a real estate licensee. In order to fulfill the requirement of the statute, however, the proposal includes this consideration within subdivision (c) to express, rather than imply, that this characteristic is part of the Criteria for Substantial Relationship.

The proposed Section 2910.5 cites and addresses AB 2138's amendment of B&P Section 480. That amendment permits DRE to base an application denial on financial crimes beyond the bill's seven-year statute of limitations, but requires that this category of crime be set out in regulations. The existing language of the Criteria for Substantial Relationship already focus on financial crimes, although other types of substantially related crimes are represented in Section 2910, subdivision (a). The proposed Section 2910.5 defines "financial crime" with specific characteristics of such offenses. Notably, these characteristics may overlap one another, with a specific crime covered by more than one of the characteristics. DRE drafted the section with the intent that a crime with one or more of the characteristics will fit the definition, with only one characteristic sufficient to qualify the crime as a financial crime.

Further, Section 10166.05 of the Code, relating to issuance of mortgage loan originator license endorsements¹, requires denial of such an endorsement where the Commissioner finds that the applicant has ever suffered an unexpunged felony conviction for specified categories of financial crimes. This requirement springs from a specific federal law, found at Title 12, Section 5104(b)(2)(B) of the United States Code Service. In order to remain consistent with this federally-

¹ Section 10166.05 is part of the State of California's implementation of the federal Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (Public Law 110-289). ("SAFE Act") Enforced by both DRE and the Department of Business Oversight, DRE's portion of the statutes related to the SAFE Act appear at Sections 10166.01 to 10166.17 of the Code.

imposed language, the proposed Section 2910.5, subdivision (b)(4) cites to that federal statute within the text of the regulation and duplicates the scope set forth in that statute, thus including such crimes within this regulatory definition of a financial crime.

Finally, existing references to “Bureau” or “department” are changed to “Department” for consistency.

TECHNICAL, THEORETICAL, AND/OR EMPIRICAL STUDY, REPORTS, OR DOCUMENTS

DRE did not rely upon any technical, theoretical, or empirical study in developing this proposed regulation.

ECONOMIC IMPACT ASSESSMENT/ANALYSIS

In the most recent complete fiscal year, 2018-19, DRE received 67,792 applications for a license. Of these, 1,217 applications involved an applicant with a conviction or past license discipline action that implicated the Criteria for Substantial Relationship. Of those, only 179 cases warranted filing a “Statement of Issues,” whereby DRE sought to deny the application. Ultimately, the application was denied in 79 cases, preventing the applicant from beginning work as a real estate licensee. DRE believes these figures to be representative of an “average” year. Thus, less than 100 persons per year may be economically impacted by the regulations changes that AB 2138 requires.²

As noted above, most of the considerations that AB 2138 imposes upon the existing Criteria for Substantial Relationship are already part of DRE’s overall review of a license application. Issues such as consideration of nature and severity of the offense will not undergo a practical change via this regulation or

² DRE estimates that one provision of AB 2138 that is not reflected in this regulations proposal will have a significantly higher impact in reducing the number of license applications presently denied. AB 2138 restricts licensing agencies from requiring the applicant to disclose convictions on the license application. This restriction has no implication for DRE’s Regulations. Although DRE does not maintain statistics on the basis for each Statement of Issues case, failure to disclose prior convictions is among the most common causes of action in Statement of Issues cases, often combined in the pleading with a cause of action arising from the underlying conviction.

the underlying statute. However, the seven year limitation on consideration of some convictions may impact some cases. DRE does not maintain statistics on the causes of action that lead to discipline cases, so a specific statement regarding the proportion of application denials that would be impacted is not possible without a manual review of the underlying cases. In compliance with Section 11346.2(b)(5) of the Government Code, DRE relies on the data cited in the prior paragraph – only 79 outright application denials in the most recent fiscal year – to assert that fewer than 100 persons in any given year could be impacted by this statutory and regulatory change.

For those persons, this regulation may allow the applicant to begin work as a real estate licensee. As most licensees now function as independent contractors, each new licensee may be considered to be a new business, rather than a “job.”

Given this data, the Department makes the following findings.

- The proposal will not impact the creation or elimination of jobs available within the State of California, as the demand for licensed real estate services will not be impacted.
- The proposal may affect the creation of new business or the elimination of existing businesses within the State of California, as a small number of additional persons will receive a real estate license rather than an application denial. These persons will likely establish a brokerage or independent contractor entity to do business as a licensee.
- The proposal does not affect the expansion of existing businesses within the State of California. Existing licensees will not be significantly impacted by the addition of a small number of additional licensees to the pool of licensees.
- The proposal does not affect the elimination of existing businesses within the State of California. Again, existing licensees will not be significantly impacted by the addition of a small number of additional licensees to the pool of licensees.
- The proposal will benefit those applicants who would otherwise not qualify for licensure based upon a prior criminal conviction that the proposal eliminates from “substantial relationship,” while not adversely affecting the health and welfare of California residents, worker safety, or the State’s environment. DRE will still be able to substantially complete its public protection function.

REASONABLE ALTERNATIVES TO THE PROPOSED REGULATION AND DRE'S REASONS FOR REJECTING THOSE ALTERNATIVES

- **Alternative 1: Adopt a definition of “financial crime” that cites specific offenses that appear within the Penal Code.** In its public protection role, DRE must consider convictions from California and other jurisdictions. The definition proposed encompasses crimes from all jurisdictions, yet is specific enough about the characteristics of a “financial crime” to ensure that the regulation will not be deemed “vague.” Also, to ensure that DRE’s enforcement of the SAFE Act remains in compliance with the federal statutory standard for that program, the proposed regulation includes a specific reference to that statutory standard and duplicates the language of that statute.
- **Alternative 2: Where AB 2138 requires inclusion within the Criteria for Substantial Relationship elements that are presently considered under the Criteria for Rehabilitation, delete those elements from the present Criteria for Rehabilitation.** DRE considered this deletion, but these elements remain a practical part of the analysis of an applicant’s rehabilitation. Where an applicant with a past conviction has remained free of additional convictions over a period of time, this is a strong indicator that the applicant has experience rehabilitative change. Where the nature and severity of a conviction warrant, a finder of fact may look for greater or lesser evidence of rehabilitation in other elements of those Criteria. As noted elsewhere, the addition of these elements to the Criteria for Substantial Relationship do not substantially change the overall value of the elements for DRE’s purposes, as DRE already addresses these elements in each case that involves past wrongdoing.

The Commissioner finds that no alternatives she has considered would be (1) more effective in carrying out the purpose of the proposed regulation through establishment of a clear and minimally burdensome filing standard and (2) would be as effective and less burdensome to affected private persons than the proposed regulation amendment.

DETERMINATION REGARDING USE OF SPECIFIC TECHNOLOGY OR EQUIPMENT

The proposed regulation does not include any requirement that a specific technology or equipment be used by any affected party.