As required by Section 11346.9 of the Government Code, the California Corporations Commissioner ("Commissioner") sets forth below the reasons for the adoption of Sections 1580 through 1596 to Article 13 of Subchapter 6 of Title 10 of the California Code of Regulations (10 C.C.R. Sections 1580 through 1596).

In an effort to expand access to responsible, reasonably priced small-dollar loans in California, Senate Bill 1146 (Chap 640, Stats. 2010) created the Pilot Program for Affordable Credit-Building Opportunities under the California Finance Lenders Law. The pilot program seeks to increase the availability of credit-building opportunities for individuals, particularly the unbanked community, by providing on a trial basis a less costly alternative to payday loans.

According to the Department of Corporations’ ("Department") data, almost 12 million short term loans were made in 2009 in California under the California Deferred Deposit Transaction Law (Financial Code Section 23000 et seq.). (See the Department’s Report, the 2009 Annual Report; Operation of Deferred Deposit Originators under the Deferred Deposit Originator Law, June 30, 2010.) These loans permit borrowers to obtain small loans (less than $300) for up to 31 days. In contrast, according to the Department’s data under the California Finance Lenders Law (Financial Code Section 22000 et seq.), only about 150,000 unsecured loans of less than $2,500 were made during 2009. (See the Department’s Report, the 2009 Annual Report; Operation of Finance Lenders under the California Finance Lenders Law, September 15, 2010.) Finance lenders assert that small-loan lending is prohibitively expensive for lenders and therefore not profitable because the California Finance Lenders Law limits the amount of interest and fees that lenders may charge on small loans. The lenders contend that because administrative costs are the same in underwriting a small or large loan, they are unable to profitably offer affordable small-dollar loans under the California Finance Lenders Law. (See Senate Bill 1146 Assembly Floor Analysis, August 20, 2010.)

As a result, according to the Assembly Floor Analysis, many Californians have only one option for small loans, payday loans, and no opportunity to build or repair their credit. In addition, many people do not have access to mainstream credit options due to minimal credit history. This history is often due to the lack of a relationship with a banking institution through a checking or savings account. Further, a consumer without a checking account does not have access to a payday loan as payday loans are contingent upon the borrower having a checking account. Consequently, in some cases an unbanked borrower does not have any access to affordable credit. The Pilot Program for Affordable Credit-Building Opportunities is intended to provide Californians with additional options for small loans. The pilot program is effective January 1, 2011 until January 1, 2015, and the bill requires the Department to evaluate the performance of the program in making affordable credit more available in California.
Specifically, the pilot program seeks to develop a market for small-dollar loans by making small-loan lending more profitable for finance lenders under the California Finance Lenders Law; increase the availability of reasonably priced small loans for consumers; and move consumers, including unbanked individuals, away from costly fringe banking and into more traditional forms of lending through which they can familiarize themselves with loan terms and borrow at better interest rates. By permitting approved lenders to charge a higher interest rate and fees on small loans made under the pilot program, the program seeks to create a market for reasonably priced small loans. At the same time, the pilot program provides borrowers with many consumer protections such as requiring lenders to consider the borrower’s ability to repay the loan and by making consumer credit education available to borrowers at no charge.

Adoption of Rules for Pilot Program for Affordable Credit-Building Opportunities

Section 1580

This rule requires licensees to notify the Department concerning any change to the information contained in the finder registration form, and provides the procedures and time period for communicating the changed information to the Department. Licensees are already required under existing regulation to maintain on file with the Department a current list of the licensee’s officers and directors (Section 1409 of the rules) and to file an amendment with the Department for any change to information in the license application (Section 1409.1 of the rules). Section 1580 is necessary to inform licensees of the procedure for notifying the Department of changes to registered finders, to assist the Department in maintaining up-to-date information on the status of a licensee’s finders and to ensure that regulations requiring licensees to maintain current information is consistent under the California Finance Lenders Law.

Section 1581

This rule sets forth the application form, application review period and filing procedures for any licensee wishing to participate in the pilot program. Only lenders who are licensed under the California Finance Lenders Law may apply to participate in the pilot program. The rule ensures that the Department has oversight of all lenders participating in the program and that only lenders approved by the Department are making loans under the pilot program.

Section 1582

This rule sets forth the finder registration form, review period and filing procedures for any licensee that uses a finder in the course of business under the pilot program. Senate Bill 1146 defines a finder as an entity that brings a licensee and prospective borrower together for the purpose of negotiating a loan contract. Senate Bill 1146 requires finders to be registered, but not licensed, by the Department. Section 1582 ensures that the Department, through the registration of finders, is able to monitor the activities of all of the finders being used by licensees.
Section 1583

Senate Bill 1146 authorizes the Commissioner to determine the amount of the filing fee for an application under the pilot program. This rule sets forth the amount of the filing fee based on the Department’s estimate of the costs to administer the pilot program. Licensees are responsible for paying the one-time application filing fee when the application is filed with the Department. The fee is scaled based on the number of licensed locations of the finance lender, beginning at $250. The rule helps ensure that the costs to administer the pilot program are recovered through the filing fee.

Section 1584

This rule sets forth the amount of the annual finder registration fee and the method for calculating the fee for a licensee. Senate Bill 1146 provides that the finder registration fee shall be paid annually by licensees, based on the number of finders used by the licensee. Senate Bill 1146 does not specify the amount of the fee, but authorizes the Commissioner to determine the amount. The fee set forth in Section 1584 is scaled for each finder, based on the number of locations of each finder, and begins at $100 annually. This rule helps ensure that the assessment of the annual finder registration fee is clear and fair to licensees, and bears a relationship to the extent of finder activity occurring by the finder based on the number of locations where the finder may be engaged in finder activity.

Section 1585

This rule sets forth the annual report form and filing time frame for the report required by Section 22349.2 of the Financial Code. Licensees under many of the lending laws administered by the Department, including the California Finance Lenders Law, are required to submit to the Department similar annual reports at the end of each calendar year. The reports provide information on the business operations, including the number and types of loans made by licensees. The Department uses this information to identify lending and industry trends, and to better understand and monitor the business operations of its licensees. The information is also needed for the Department to evaluate the pilot program and report to the Legislature as required by Section 22361 of the Financial Code.

Section 1586

Senate Bill 1146 requires the Commissioner to submit a report to the Legislature by January 1, 2014, evaluating the performance of the pilot program, and further specifies the information that must be included in that report. The Department anticipates collecting this information from the annual reports submitted to the Department by licensees. However, some of the information required in the Legislature’s report, such as census tract information of borrowers, may not be information typically collected in a loan transaction by licensees and therefore licensees must be aware upon commencement of lending that they must collect this information for purposes of preparing complete annual reports at year end. This rule is necessary to ensure that licenses understand the data that must be collected from borrowers.
Section 1587

One of the purposes of Senate Bill 1146 is to help borrowers understand, build and manage credit by making credit education available at no cost to borrowers. Specifically, Senate Bill 1146 requires licensees to offer a credit education program or seminar to borrowers, and further requires the Commissioner to review and approve credit education programs or seminars before a licensee may offer the program or seminar to a borrower. Accordingly, a licensee may only offer a credit education program that has already been reviewed and approved by the Department. Licensees must provide to the Department for review and approval information concerning the credit education program or seminar that they are proposing to offer. This rule sets forth the information licensees need to submit concerning credit education programs and seminars and establishes the Department’s criteria for approving credit education programs or seminars.

Section 1588

This rule identifies the procedures a licensee must follow when offering a credit education program or seminar to borrowers. The regulation is necessary to ensure that licensees are in fact offering a program or seminar to borrowers and to enable the Department to ascertain licensee compliance with the law.

Section 1589

Senate Bill 1146 requires licensees to report each borrower’s payment performance to at least one of the national credit reporting agencies and imposes lender loan underwriting standards that are more stringent than those under the California Finance Lenders Law. This rule is needed to provide licensees with uniform record keeping procedures and to enable the Department to ascertain compliance with the law.

Section 1590

Senate Bill 1146 imposes many requirements on payment of compensation to a finder, such as prohibiting a licensee from compensating finders who are barred by the Commissioner from providing services. This requirement imposes a duty on a licensee to verify a finder’s status before paying the finder. The rule is necessary to set forth procedures to enable licensees to determine whether a finder has been barred.

Section 1591

When a borrower applies for a loan under the program, Senate Bill 1146 requires licensees to provide the borrower with written notice concerning the amount of interest and loan payments, and the borrower’s right to rescind the loan within a specified time. The purpose is to ensure that borrowers are fully informed about the costs of a loan and to provide borrowers with a “cooling off” period. This rule sets forth the procedures for licensees to follow in providing the notices to borrowers. The regulation is necessary to provide licensees with clear procedures to prevent misunderstanding with borrowers and to enable the Department to ascertain licensee compliance with the law.
Section 1592

Senate Bill 1146 requires both the finder and the licensee to provide notice to borrowers disclosing the relationship between the finder and licensee, and how to make a complaint to the Department about a finder or a licensee. This rule sets forth the procedures for finders and licensees to follow in providing the disclosure notice to borrowers, and is necessary to enable the Department to ascertain licensee compliance with the law.

Section 1593

Senate Bill 1146 imposes restrictions on the activities and services of finders, places requirements on licensees who use finders, and authorizes the Department to examine the activities of finders. A licensee may be disciplined for violations committed by its finders. This rule is necessary to clarify the recordkeeping and record retention requirements for finders to prevent misunderstanding and to enable the Department to ascertain finder compliance with the law.

Section 1594

Senate Bill 1146 provides that a finder is acting as a finder when it receives or processes an application. However, the bill does not define what is meant by “receives” or “processes” an application. This rule is needed to clarify that a finder receives or processes an application when it is doing one or more of the specified services.

Section 1595

Senate Bill 1146 does not require finders to be licensed by the Department, but the California Finance Lenders Law does require finance brokers to be licensed. Finders are different from finance brokers in that finance brokers may advise, counsel or negotiate loans with borrowers, while finders may not. This rule clarifies the meaning of “counseling” and “advice” to prevent misunderstanding of the law.

Section 1596

Senate Bill 1146 requires the Commissioner to conduct a random sample survey of borrowers to obtain information regarding the borrower’s experience and licensees’ compliance with the law. This rule sets forth the information that licensees must make available to the Department for purposes of conducting the survey.

DETERMINATION GOVERNMENT CODE SECTION 11346.9(a)(2)

The Commissioner has determined that the adoption of the regulation 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.
ALTERNATIVES CONSIDERED

No alternative considered by the Department would be more effective in carrying out the purpose for which the regulation is proposed, or would be as effective and less burdensome to affected private persons, or would lessen any adverse impact on small businesses. Under Government Code Section 11342.610(b), a finance lender is not a small business, and therefore no alternatives would lessen the impact of this rulemaking action on small business.

ADDENDUM, REGARDING PUBLIC COMMENTS

No request for hearing was received during the 45-day public comment period, which ended on April 11, 2011. Accordingly, no hearing was scheduled or held.

COMMENTS RECEIVED DURING THE 45-DAY COMMENT PERIOD

The Department did not receive comments during the 45-day public comment period.

Because proposed amendments to Sections 1550 and 1552 were not included in the final text, and the final text of Sections 1581, 1582, 1584, and 1585 differs from the text of the regulations dated February 3, 2011, a copy of the final text was made available to the public in accordance with the requirements of Government Code Section 11346.8(c).

Changes were made to the text of the regulations dated February 3, 2011, to clarify the information that licensees and finders must provide to the Department and to update the San Francisco office address.

COMMENTS RECEIVED DURING THE 15-DAY COMMENT PERIOD

The Department received two public comment letters during the 15-day public comment period, which ended on May 18, 2011. Those comments are summarized below, together with the Department’s response.

1. COMMENTOR: E-mail dated May 12, 2011, from Bruce Weiner, BSL Financial Services, Inc. Mr. Weiner subsequently withdrew his comments via an e-mail dated May 12, 2011.

2. COMMENTOR: E-mail and letter dated May 18, 2011, from Paul Soter of the Law Offices of Paul Soter.

COMMENT 1: Commentor recommends that the Department amend the sentence after the second checkbox in Exhibit C regarding the automated underwriting system (Section 1582(c); the Finder Registration form). Commentor states that underwriting may be done manually or by using automated tools. As written, only automated underwriting systems are permitted when using finders.
RESPONSE: The Department has incorporated the recommended language into the final rules.

COMMENT 2: Commentor suggests clarification is needed in Exhibit C (sentence after final checkbox) regarding where signed original documents are to be kept (Section 1582(c); the Finder Registration form).

RESPONSE: The Department has modified the language as recommended by commentor.

COMMENT 3: Commentor recommends that the term “written communication” in Item 3 in Exhibit C of the Finder Registration form (Section 1582(c)), below “A person who performs any of the following activities is a broker within the meaning of Section 22004 of the Financial Code and is required to obtain a broker’s license:”, should be amended.

RESPONSE: The section referenced does not include the term “written communication,” and therefore the Department has not amended the section.

COMMENT 4: Commentor recommends that Item 4 in Exhibit C of the Finder Registration form (Section 1582(c)), below “A person who performs any of the following activities is a broker within the meaning of Section 22004 of the Financial Code and is required to obtain a broker’s license:”, should be deleted because a California Finance Lender broker must conduct business only at licensed places of business.

RESPONSE: This section does not mean that providing services at a location other than the business location is something that is only reserved for a broker as the commentor suggests. It simply means that a finder is only authorized to conduct services under this division from one of its business locations. The finder’s business location is not a licensed location. The section has been revised to add that the location must be reported to the Commissioner.

COMMENT 5: Commentor recommends that the regulations be amended to include a record retention requirement for finders.

RESPONSE: Section 1593 was amended to include a 2-year retention period for records of finders.

COMMENT 6: Commentor suggests that the regulations be amended to allow the annual report to be submitted electronically in a PDF format (Section 1585(b)).

RESPONSE: The current language does not preclude the use of a PDF form, if available, and therefore no change to the rules was made.

COMMENT 7: Commentor recommends numerous clarifications and/or deletions to the annual report form (Section 1585(b)):

a. The second paragraph of the instructions should also include “no new loans, no interest or fees were received, and collection efforts were made on unpaid loans.”
b. The information required in the instructions for Schedule B discourages potential customers and may contradict the requirements of Civil Code Section 1812.30 and therefore should be deleted.

c. Schedule E instructions should be amended to state “annual percentage” rather than “annualized percentage”.

d. The instructions to the ANNUAL REPORT FORM AVAILABLE ON THE INTERNET section should be amended to state that the report is an Adobe Acrobat form that must be downloaded, printed and mailed.

e. The seven-digit license number in the instructions to the ANNUAL REPORT FORM AVAILABLE ON THE INTERNET section is inaccurate.

f. Public inspection of individual annual reports should be removed from the instructions.

g. The instructions to the annual report are ambiguous when reporting on more than seven finders.

h. The last column of Item A-3(a) should be deleted because it may have a negative impact on the borrower’s credit score. Commentor also notes that the report does not collect information about decreasing credit scores.

i. The last column of Item A-3(b) should be deleted because it may have a negative impact on the borrower’s credit score. Commentor also notes that the report does not collect information about decreasing credit scores.

j. The last column of Items B-2(a) and B-2(b) should also include payday loans.

k-t. Each of the Items in Schedule C should indicate “Principle Amount” in each of the columns with dollar headings.

u-z. In Schedule E, the term “Annualized Rate of Charge” should be corrected to “Annual Percentage Rate.” APR means annual percentage rate.

RESPONSE:

a. “No business” is clearly defined in the instructions, and therefore no change was made. This definition is consistent with the annual report requirement under Financial Code Section 22159.

b. Financial Code Section 22361(d)(6) requires the licensee to report the income distribution of borrowers in the annual report. The licensee must determine the census tract (low, moderate, etc.) for the residence in which the borrower resides. The licensee does not have to ask or obtain the family’s income to complete Schedule B. Therefore, no change has been made. The Department’s annual report form and the Department’s website referenced in the instructions to the annual report define each census tract level.

c. The Department has incorporated the recommended language into the final rules.

d. The Department has made revisions to clarify this section.

e. The Department has eliminated the reference.

f. Financial Code Section 22361(b) provides that the information disclosed to the Commissioner for the purpose of preparing the report to the Legislature is exempt from public disclosure under Government Code Section 6254(d)(2). Consequently, the Department agrees with commentor that the report is not a public document and has removed the language.

g. The Department has amended the COMPLETENESS & ACCURACY
section in the instructions to provide additional clarity.

h. Financial Code Section 22361(d)(5) specifically requires this information be provided to the Legislature, and therefore no change is being made. This schedule reports information on repeat borrowers. Each time an application for a new loan is taken, a new credit report is generally pulled to verify the borrower’s monthly expenses. The purpose of the pilot program is to help borrowers build credit. Without this information, the Department will be unable to determine whether the program is achieving this purpose.

i. For the same reason described in the response to Comment 7.h. above, no change has been made.

j. The Department has amended the language as recommended by commentor.

k-t. The Department has amended the language as recommended by commentor.

u-z. The Department has amended the language as recommended by commentor.

COMMENT 8: Commentor recommends that the information in Section 1586(a)(2) should be deleted because income by census tract is burdensome to complete and not required by law.

RESPONSE: The information is required under Financial Code Section 22361(d)(6), and therefore the Department is not making the recommended change. Specifically, the Department is required to include this information in its report to the Legislature.

COMMENT 9: Commentor recommends that Section 1586(a)(4) should be amended to include payday loan services.

RESPONSE: The Department has amended the language as recommended by commentor.

COMMENT 10: Commentor recommends that Section 1586(a)(6) should be deleted because information on attendance at credit education programs should instead be collected in customer surveys.

RESPONSE: The Department has modified the provision to include the qualifier “if known.”

COMMENT 11: Commentor recommends that the regulations be amended to allow finders and licensees to save documents electronically.

RESPONSE: The Department has determined that no change is necessary, because Financial Code Section 22337(e)(1) to (3) already allows lenders to electronically store documents.

COMMENT 12: Commentor recommends that the regulations be amended to permit lenders who use paper forms to scan their documents for electronic storage.
RESPONSE: The Department has determined that no change is necessary, for the same reason set for in the response to Comment 11 above.

COMMENTS RECEIVED DURING THE SECOND 15-DAY COMMENT PERIOD

The Department did not receive comments during the Second 15-day public comment period, which ended on September 9, 2011.