

Date of Hearing: April 15, 2024

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Timothy Grayson, Chair

AB 2981 (Chen) – As Amended April 8, 2024

SUBJECT: Finance lenders: exemption from licensure

SUMMARY: This bill specifies that a commercial finance lender that does not make or broker residential mortgage loans or consumer loans shall be deemed a licensee under the California Financing Law if that finance lender makes five or fewer commercial loans annually and the principal amount of each loan exceeds \$350,000.

EXISTING LAW:

- 1) Establishes the California Financing Law (CFL), which regulates specified finance lenders and brokers making certain types of commercial loans. (Fin. Code, div. 9, §§ 22000 et seq.)
- 2) Defines “commercial financing” as an accounts receivable purchase transaction, including factoring, asset-based lending transaction, commercial loan, commercial open-end credit plan, or lease financing transaction intended by the recipient for use primarily for other than personal, family, or household purposes. (Financial Code Sec. 22800 (d))
- 3) Defines “commercial loan” as a loan of a principal amount of five thousand dollars (\$5,000) or more, or any loan under an open-end credit program, whether secured by either real or personal property, or both, or unsecured, the proceeds of which are intended by the borrower for use primarily for other than personal, family, or household purposes. (Financial Code Sec. 22502)
- 4) Exempts from CFL licensure the following types of commercial lenders:
 - a) Any person who makes no more than one loan in a 12-month period if that loan is a commercial loan. (Financial Code Section 22050.5)
 - b) Any person who makes five or fewer loans in a 12-month period, these loans are commercial loans as defined in Section 22502, and the loans are incidental to the business of the person relying upon the exemption. (Financial Code Section 2250)

FISCAL EFFECT: Unknown. This bill is keyed Fiscal by Legislative Counsel.

COMMENTS:

1) **Purpose.**

According to the author:

AB 2981 will address the delays and backlogs in processing licensing and background check applications at the Department of Financial Protection and Innovation (DFPI) for occasional commercial lenders.

2) **Background: Existing CFL exemptions for commercial lenders**

Generally, California law has allowed for some type of “de minimis” exemption that would allow for limited commercial lending without the need for the lender to become licensed under the CFL. This exemption was first created in 1997 and allowed for one commercial loan in a 12-month period without triggering a licensing requirement. AB 1091 (Skinner), Chapter 243, Statutes of 2013, replaced this exemption with a five-loan de minimum exemption so long as those loans were “incidental” to the business of the entity making the loans. The intent of this change was to minimize unnecessary over-regulation of businesses by exempting certain commercial financing transactions structured as loans by entities that are not otherwise lenders.

However, AB 1091’s change to the de minimis exemption led to unintended consequences for entities that help facilitate loans eligible for federal New Market Tax Credits (NMTC). NMTC transactions are carried out through a subsidiary which is created specifically to raise tax credit equity and to make a loan to a qualifying borrower. Therefore, NMTC lenders are typically created for the express purpose of making one loan in a low-income community, which means these entities were not able to use the new exemption because these loans were not “incidental.”

In response, AB 777 (Lara), Chapter 478, Statutes of 2016, addressed the above issue by re-adding the one-loan de minimis exemption but leaving unchanged the newer five-loan de minimis exemption. SB 777 also included a January 1, 2022 sunset date for the added exemption, which was then removed by SB 577 (Limón), Chapter 577, Statutes of 2021.

3) **What does AB 2981 do? And why is it needed?**

AB 2981 deems an entity as being licensed under the CFL if it makes fewer than five loans makes five or fewer commercial loans a year and if the principal amounts of each loan exceeds \$350,000. Thus, unlike the existing licensure exemption for companies whose limited commercial loan activity is “incidental,” AB 2981 would apply to entities whose sole purpose is to offer a limited number of high-value commercial loans.

This bill does not provide for an explicit exemption from the CFL and its requirements. Rather, AB 2981 would possibly allow these companies to bypass the application process altogether and be deemed licensee by virtue of being a very specific type of lender specializing in a small number of large commercial transactions.

According to the author’s office, the CFL’s licensure process is impractical for certain types of institutional commercial lenders. As an illustrative example, a special-purpose vehicle (SPV) is a legal entity that allows multiple investors to pool capital and finance a specific investment, and these entities can also be formed to make just a small number of large, complex loans to sophisticated borrowers. Because an SPV does not necessarily have employees, prior activity, or a unified management or organizational structure, the author’s office argues this type of entity does not align well with the CFL application process. These practical and administrative challenges have led to significant delays and confusion for companies hoping to make a small number of large loans in California.

Importantly, the mere fact that an entity is organized as an SPV or some other legal entity does not mean it cannot nor should not obtain a CFL license. A brief review of DFPI

enforcement actions reveals that SPVs do obtain CFL licenses and do violate the law.¹ Because large commercial lenders can compartmentalize and organize their financial activities in different ways and for different purposes, it is hard to know just what type of entity is at odds with the licensure process, as the bill's supporters argue, and which type is not.

At the same time, AB 2981 recognizes that complex commercial transactions in the hundreds of thousands of dollars typically involve sophisticated actors with and the resources to evaluate the agreements they are entering into. AB 2981 presents an important question: What is the purpose of the CFL, and whom does it protect? This bill proposes a partial answer to that question: There is a group of sophisticated commercial borrowers who do not benefit from the protections granted by the CFL's application process, and the juice is simply not worth the squeeze to get them licensed.

If AB 2981 moves forward, there are remaining issues the author will need to resolve. The bill's approach to deem an entity a licensee rather than fully exempt the entity from the CFL solves some problems (such as ensuring the CFL's protections apply) but perhaps causes other problems. These problems are largely mechanical: How does DFPI enforce the CFL if DFPI does not have the kinds of information a license application provides? And, does this entity pay the CFL licensee fees and file the annual report? As the bill moves forward, the author will need to work with the regulator to fine tune this concept.

4) **Support.**

AB 2981 is sponsored by Ares Management LLC, who writes:

Ares is a California headquartered U.S. Securities and Exchange Commission registered investment advisor. Credit funds managed by Ares are focused on delivering comprehensive financing solutions primarily to middle market companies in the United States. Middle market companies often face challenges in accessing traditional bank loans due to stringent requirements and institutional credit lenders like Ares make financing more accessible to these businesses. Overall, institutional credit lenders like Ares provide middle market companies with much-needed financing options that are tailored to their specific needs and circumstances, helping them to grow and thrive in the competitive business landscape. Ares credit funds have a meaningful number of portfolio companies headquartered in California.

Under current law, any individual or company that engages in the business of making commercial loans or acting as a broker in connection with loans made by a finance lender is required to obtain a finance lender license through the National Mortgage Licensing System. The license application requires detailed sensitive personal information about finance company owners, including fingerprints and personal financial disclosures. In many cases for institutional commercial lenders like Ares, these application requirements are inapplicable or impossible to meet,

¹ See, for example: <https://dfpi.ca.gov/enf-e/encina-equipment-finance-spv-llc/>, <https://dfpi.ca.gov/enf-s/sic-jv-spv-funding-i-llc/>, <https://dfpi.ca.gov/enf-m/mcc-jv-spv-funding-i-llc/>

and this causes delays and confusion at the DFPI and in many instances prevents or delays institutional credit lenders like Ares from making loans to mid-sized California companies.

REGISTERED SUPPORT / OPPOSITION:

Support

Ares Management LLC (sponsor)

Opposition

None on file.

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