

Date of Hearing: April 23, 2018

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Monique Limón, Chair

AB 3207 (Limón) – As Amended April 4, 2018

**SUBJECT:** California Financing Law

**SUMMARY:** Revises the definition of “broker” under the California Financing Law (CFL) to include anyone who, among other things, receives compensation for providing a referral or a lead if the referral or lead conveys confidential information, participates in any loan negotiation between a finance lender and prospective borrower, participates in the preparation of loan documents, communicates lending decisions or inquiries to a borrower, or charges any fees to a prospective borrower or applicant for any services related to an application for a loan from a finance lenders.

Specifically, **this bill:**

- 1) Defines a “broker” to mean any person who is engaged in the business of negotiating or performing any act as broker in connection with loans made by a finance lender, including, but not limited to, any of the following acts:
  - Providing a referral or a lead to one or more finance lenders for compensation or expected compensation if the referral or lead conveys confidential data, as specified.
  - Participating in any loan negotiation between a finance lender and prospective borrower.
  - Counseling, advising, or making recommendations to a borrower about a loan based on a borrower’s confidential data.
  - Participating in the preparation of any loan documents, including loan applications, other than providing a borrower blank copies of loan documents. Transmitting information that is not confidential data at the request of a prospective borrower or loan applicant shall not, by itself, constitute participation in the preparation of loan documents.
  - Communicating lending decisions or inquiries between a finance lender and a borrower.
  - Charging any fees to a prospective borrower or applicant for any services related to a prospective borrower’s or applicant’s application for a loan from a finance lender.
- 2) Defines “confidential data” to mean information about a borrower, prospective borrower, or applicant that is nonpublic and sensitive, including but not limited to, the following:
  - Bank account number or routing number, bank statement, or credit or debit card account number.
  - Credit score, whether self-reported by the person it relates to, or received from a credit reporting agency as part of an official request.

- Social Security number (SSN), part of an SSN, driver's license number or government-issued identification number, or passport number.
  - Personal or business income information, including information self-reported by the person, personal employment data or history, or taxpayer or employer identification number.
  - Date of birth, mother's maiden name.
  - Medical information, health insurance information, including an insurance policy number.
- 3) Provides that "confidential data" does not include: name, phone number, physical address, email address, financing amount, or stated purpose for a loan. In connection with a commercial loan, "confidential data" does not include business name, business address, business phone number, or a business's self-reported range of income, in addition to the other information listed in this paragraph.
- 4) Provides that a person shall not be deemed a broker if both of the following are met:
- The person only distributes or otherwise disseminates to a prospective borrower or applicant a finance lender's marketing materials or factual information about the finance lender and its loan products, such as the finance lender's interest rates, minimum or maximum loan amounts or loan periods, or a general description of the finance lender's underwriting criteria.
  - The person does not engage in any of the other acts specified above.
- 5) Provides that a person is not considered a "broker" if that person performs the acts described in #1 above five or fewer times in a calendar year.
- 6) Prohibits, subject to certain exceptions, a finance lender from compensating a unlicensed person for performing brokering services, as defined in #1 above. Additionally, prohibits a licensee from compensating a broker for services if the broker is known to have committed any violation of Section 22161 of the Financial Code (related to misleading behavior and fraud) in connection with that loan, and prohibits a licensee from passing through to a borrower the licensee's cost of compensating a broker.
- 7) Prohibits a licensed broker from soliciting or collecting confidential data, unless that information is reasonably necessary to perform the brokering acts described above.
- 8) Requires that a broker, prior to making a referral in connection with a loan, provide the prospective borrower a written disclosure that shows in clear and distinct terms the method of compensation provided to the licensed broker, including whether the compensation is based on the size of a loan or contingent on the referral or lead resulting in a consummated loan.
- 9) Requires that a finance lender, prior to consummating a loan, provide the prospective borrower a written disclosure that shows in clear and distinct terms the amount paid to any broker in connection with the loan, and how the compensation was determined, including

whether the compensation was based on the size of a loan or contingent on the referral or lead resulting in a consummated loan.

**EXISTING LAW:**

- 1) Defines a “broker” under the CFL as a person who is engaged in the business of negotiating or performing any act as a broker in connection with loans made by a finance lender (Financial Code Section 22004). Prohibits any person from engaging in the business of a broker without obtaining a license from the commissioner of the Department of Business Oversight (Section 22100).
- 2) Prohibits a finance lender from paying any compensation to an unlicensed person or company for soliciting or accepting applications for loans. This prohibition does not apply to the payment of compensation to an employee of the lender, a real estate broker, or to compensation paid for any brokerage service provided by a bank, savings and loan association, or other financial institution that is exempted from the CFL. (Title 10 California Code of Regulations Section 1451)
- 3) Contains two limited exceptions to the prohibition against compensating unlicensed persons in connection with the solicitation or acceptance of applications for loans:
  - Lenders accepted to participate in the Pilot Program for Increased Access to Responsible Small-Dollar Loans (pilot program) may use the services of one or more finders, as defined. Finders authorized under the pilot program need not be licensed, if they engage in one or more of eight activities that generally involve helping borrowers fill out loan applications and communicating with lenders about the status of and final decision on borrowers’ loan applications. Pilot program finders may also engage in one or more of three additional activities (disbursing loan proceeds, accepting loan payments, and providing borrower disclosures) if they hold specified licenses. The ability of pilot program lenders to compensate finders is subject to several limitations. The commissioner has examination and disciplinary authority over pilot program finders. (Financial Code Sections 22371 – 22376)
  - CFLL licensees that make commercial loans may compensate unlicensed persons in connection with the referral of one or more prospective borrowers, when all of the following occur: the referral leads to a consummated loan, the loan contract provides for an annual percentage rate that does not exceed 36 percent, the licensee follows specified requirements when underwriting the loan, the licensee maintains records of all compensation paid to unlicensed persons, and the licensee annually submits information to the commissioner. Unlicensed persons that receive compensation may not engage in one or more of eight specific activities involving loans, except as specified. (Financial Code Section 22602)

**FISCAL EFFECT:** Unknown

**COMMENTS:**

1) PURPOSE

The author states:

“There are currently unlicensed third parties (aka lead generators) that solicit confidential financial information from consumers and provide this information to lenders for compensation. These third parties provide advice or recommendations to consumers that may not be in the best interest of the consumer. For example, an unlicensed third party may steer consumers into loans with higher costs because the lender is willing to pay more to the third party than a lender with lower cost loans for the referral is willing to pay.

DBO currently has 46 open cases related to unlicensed broker activities. These cases can be difficult for the department to enforce due to the poor construction of Financial Code Section 22004. Through consumer complaints and routine examinations, DBO has become aware of consumer harm due to the activities of lead generators. Without clearer statutory authority, DBO cannot prevent this harm from continuing.”

## 2) BACKGROUND

Many provisions of the California Financing Law (CFL), including the definition of “broker,” were drafted decades before the Internet was developed. In recent years, consumers looking for personal loans have increasingly used the Internet to search for lenders. Companies have developed sophisticated online lead generation practices to respond to this consumer demand, including highly-targeted online advertisements and automated, real-time auction houses for consumer data.

Online lead generators serve a variety of industries, including hotels, for-profit education providers, insurance, and loans. This bill requires licensure of lead generators that serve the nonbank lending market in California (i.e., provide leads to CFL finance lenders). Lead generators that serve the CFL loan market play an important role in bringing borrowers and lenders together based on a borrower’s confidential information and the general underwriting characteristics of a lender. When serving this intermediary role and receiving compensation for this activity, the incentives of lead generators may be misaligned with the best interests of the consumer who provides their confidential data. For this reason, the state can protect consumers by regulating how lead generators represent their services and requiring them to disclose their financial interests to consumers.

Loan products offered by CFL lenders have also changed significantly in recent years. In 2006, CFL lenders originated only 57 loans with a principal amount of \$2,500 to \$10,000 and interest rates exceeding 100%. In 2016, CFL lenders originated 346,501 loans with triple-digit interest rates, representing an aggregate principal amount of \$1.1 billion. The data are clear: lenders are marketing far riskier products to a much broader segment of consumers than ever before.

During the mortgage crisis of the 2000s, unlicensed third parties played a significant role in getting consumers into mortgages that they could not afford. Currently, lead generators act as unlicensed third parties in the CFL marketplace. As third parties, lead generators get paid whether or not a consumer is placed in a loan that fits their needs and that they have the ability to repay. The transactional nature of the relationship between consumers and lead generators poses risk of consumer harm, a risk that is exacerbated by the

financially vulnerable situations that lead consumers to seek out high cost loans in the first place.

### 3) RISKS TO CONSUMERS IN THE MARKET TODAY

Lead generators that serve the lending industry can serve a valuable role in the market by lowering search costs for consumers and lowering customer acquisition costs for lenders. Lead generators that provide unbiased information to consumers, adequately protect consumers' confidential data, and disclose potential conflicts of interest should be allowed to flourish in the CFL marketplace. Unfortunately, not all lead generators maintain such standards.

The Federal Trade Commission (FTC) outlines the following consumer protection concerns in its paper on lead generation (<https://www.ftc.gov/news-events/blogs/business-blog/2016/09/ftc-staff-perspective-lead-generation>).

- *Lack of transparency:* Consumers may not understand that online web forms are operated by lead generators and instead assume that they are submitting information directly to a lender. Even when consumers know they are submitting their information to a lead generator, they may not know that their information can be sold and re-sold multiple times. Consumers may also not be aware that lead generators may sell their information to the highest bidder, rather than to a lender that could offer them a loan that better fits their needs.
- *Deceptive marketing:* The lead generation ecosystem can be complex with many lead generators buying and selling an individual consumer's confidential data before the data is ultimately transmitted to a lender. Because of the many steps that can separate the entity that makes marketing claims to consumers from the lender who ultimately uses the confidential data to originate a loan, lead generators can use this lack of transparency to make misleading claims about their services, such as "we will connect you with the best loan" or "we will approve you for a loan."
- *Misuse of confidential information:* Some lead generators fail to ensure that companies that buy their leads are using that information for authorized purposes. The FTC has filed several law enforcement actions alleging that bad actors have been able to obtain payday loan leads for nefarious purposes, such as making fake debt collection calls or charging consumers' financial accounts without authorization.

In addition to the risks outlined by the FTC, online lead generators may act in their own self-interest, rather than in the interest of the consumer, when connecting a consumer with a lender. When a consumer submits their bank account number, credit score, social security number, desired loan amount, and/or income information to a lead generator, that consumer may reasonably assume that the lead generator will connect them with a lender that offers a loan product that meets the consumer's needs and credit profile. However, lead generators may connect the consumer with whichever lender is willing to pay the highest amount, regardless of whether that lender offers products that fit the consumer's needs.

#### 4) HOW THIS BILL ADDRESSES RISKS TO CONSUMERS

This bill aims to address the risks to consumers discussed in the preceding section. All code sections referenced below are from the Financial Code.

##### **Lack of transparency and conflicts of interest**

Subdivisions (g) and (h) of Section 22100 require brokers and finance lenders, respectively, to disclose in clear and distinct terms the amount paid to a broker in connection with a loan, including whether the compensation is based on the size of a loan or contingent on the consummation of a loan. Consumers can use this information to identify potential conflicts of interest. For example, a consumer may request a loan with a principal amount of \$1,000, but the lead generator refers them to a lender that only offers loans above \$2,500 (because the lender does not offer loans subject to the CFL rate caps on loans below \$2,500). If the disclosure clearly indicates that the lead generator is compensated for sending such a lead to the lender despite the difference between the consumer's desired loan amount and the loans that lender offers, a consumer may have second thoughts about consummating a loan with that lender.

##### **Deceptive marketing**

Subdivision (d) of Section 22100 prohibits a CFL licensee from compensating a broker who is known to have committed any violation of the CFL related to false, deceptive, or misleading advertising, fraudulent business practices, or dishonest dealings. Pursuant to Section 22161, CFL licensees are also prohibited from causing or permitting any false, misleading, or deceptive advertising to be displayed or distributed, which would extend the prohibition on false advertising to third parties that a lead generator may contract with.

##### **Misuse of confidential information**

Subdivision (f) of Section 22100 prohibits a broker from soliciting or collecting confidential information unless that information is reasonably necessary to perform the acts of a broker specified in the Section 22004 (a) (see #1 on page 1 of this analysis). This prohibition will minimize the amount of consumers' sensitive information that is collected and available to be bought and sold by potentially nefarious actors.

#### 5) LICENSURE IS NECESSARY FOR ADEQUATE ENFORCEMENT

The enforcement mechanisms provided by the CFL are predicated on the premise that regulated entities are licensed by the DBO. Generally, licensure provides DBO with the tools to conduct three important functions that protect consumers: upfront vetting, market monitoring and examination, and providing punishment for violations of the law.

##### **Upfront vetting**

The requirement to be licensed prior to engaging in brokering activities permits the DBO to evaluate license candidates' fitness for providing financial services. In order to obtain a license, a licensure candidate must submit an application, including the names and fingerprints of principal officers, directors, managers, and owners (aka applicants). THE

DBO is required to conduct a background check on these persons, and the Commissioner of DBO may deny an application for a license if the applicant has been convicted of a crime or committed an act involving dishonesty, fraud, or deceit within the past ten years, or if the applicant has violated the CFL. The applicant is also required to have a minimum net worth of \$25,000 and maintain a surety bond of \$25,000. These requirements establish a minimum standard for companies that are permitted to handle consumers' sensitive financial data and facilitate access to credit in the nonbank lending market in California.

### **Market monitoring and examination**

CFL licensees are required to report their activities and make their books and records open to inspection by the DBO. Licensees are required to annually report to DBO relevant information concerning the business and operations conducted by the licensee, including the licensees annual financial statements. Importantly, licensees must maintain and provide DBO access to books and records which enable DBO to evaluate the licensee's compliance with the requirements of the CFL. If DBO receives a complaint from a consumer, the ability to access books and records is pivotal to investigate the complaint, identify violations, and take enforcement actions to stop the violation from occurring. The CFL also requires licensees to maintain records related to a loan for three years after the final entry on any loan recorded in the records and to maintain advertising copy for two years after the last date of its use. These record retention requirements ensure that licensees cannot legally destroy evidence of a violation shortly after committing the violation.

### **Punishment for violations**

A CFL license is a prerequisite for any company to receive compensation for making a loan or acting as a broker, subject to specified exceptions in the CFL. If a licensee violates any provision of the CFL, DBO has the authority to take a variety of enforcement actions, up to suspension or revocation of a license, which essentially puts the company out of business. The CFL authorizes DBO to pursue the following enforcement actions based on the gravity of the violation and other factors: desist and refrain from engaging in specific activities, issue a citation containing an order to correct violations and assess an administrative fine not to exceed \$2,500, bring a civil action seeking an injunction and ancillary relief, suspend a license, and revoke a license.

## **6) CONSIDERATIONS FOR THE AUTHOR**

Based on meetings with stakeholders in support, neutral, and opposition positions, the author has identified several issues that will be addressed in future iterations of the bill. While the following is not an exhaustive list, the following issues have been raised by multiple parties and the author commits to continue working towards agreement on outstanding items if the bill moves through this committee.

- i) Section 22004(a): Delete "including, but not limited to" phrase in the definition of broker. Instead of an open-ended definition subject to interpretation by the regulator, the author may consider adding language that would require DBO to conduct a formal rulemaking if the regulator needs to clarify acts that constitute brokering activities.

- ii) Section 22004(a)(5): Add “based on a borrower’s confidential data” after “inquiries” to clarify that general requests for information do not constitute brokering activities.
- iii) Section 22004(b)(2)(G): Add “business’s email address, or a business’s desired loan or financing amount” to the list of exceptions to confidential data in connection with a commercial loan. Delete “range of” before “income.”
- iv) Section 22100(c): Add subdivision (c) of Section 22602 to the list of exceptions.
- v) Section 22100(d): Clarify that a licensee shall not *knowingly pay compensation* to any broker who has violated the CFL prohibition against false or misleading advertising.
- vi) Section 22100(e): Delete “or indirectly” related to passing through the cost of compensating a broker. Language should be clarified to reflect author’s intent that a lender charge a borrower the same amount for a loan facilitated through a broker as the lender would charge the same borrower for a loan that is not facilitated through a broker.
- vii) Sections 22100(f) and 22604(b)(1): Delete “unless that information is reasonably necessary to perform the acts in subdivision (a) of Section 22004. Clarify that a licensed broker shall not solicit, collect, or convey a person’s confidential data *without the person’s affirmative approval*.
- viii) Section 22100 (g) and (h): Regarding disclosures from brokers and lenders, determine if a duplicate disclosure provides meaningful consumer protections and determine the appropriate information to be disclosed.
- ix) Determine if a separate definition of “lead generator” should be established under the CFL based on the activities described in Section 22004(a)(1). If a separate definition is established, all requirements of “broker” or “licensee” under the CFL shall apply to “lead generator” except for specific exceptions that are determined to have no negative impact on DBO’s ability to enforce the consumer protections of the law.

## **REGISTERED SUPPORT / OPPOSITION:**

### **Support**

California Low-Income Consumer Coalition  
Center for Responsible Lending  
Consumers Union  
Department of Business Oversight  
New Economics for Women  
Office of Financial Empowerment, City and County of San Francisco  
Western Center on Law and Poverty

**Opposition**

California Financial Services Association  
Electronic Transactions Association (unless amended)  
Equipment Leasing and Financing Association

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