

Date of Hearing: April 1, 2019

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Monique Limón, Chair

AB 642 (Limón) – As Introduced February 15, 2019

SUBJECT: California Financing Law

SUMMARY: Updates the definition of “broker” under the California Financing Law (CFL) to reflect activities that occur primarily on the internet and requires brokers to provide disclosures and obtain a consumer’s consent prior to transmitting their confidential data.

Specifically, **this bill:**

- 1) Defines a “broker” as a person who is engaged in the business of performing any of the following acts:
 - a. Specified activities related to serving as an intermediary between CFL finance lenders and prospective borrowers by collecting and transmitting a prospective borrower’s confidential data¹;
 - b. advising, negotiating, or preparing a loan agreement or application;
 - c. charging a fee to a prospective borrower for any services related to a loan application.
- 2) Defines “confidential data” as any of the following: bank account number or bank statement; credit or debit card number; credit score, whether self-reported or received from a credit reporting agency; partial or full social security number; personal or business income information, whether self-reported or received from an official source; government-issued identification number; personal employment data or history; date of birth; mother’s maiden name; medical information; health insurance information; insurance policy number; and taxpayer or employer identification number. Specifies information that is not considered “confidential data.”
- 3) Prohibits a finance broker from performing an act that represents brokering without first obtaining the prospective borrower’s express consent for that purpose.
- 4) Prohibits a finance lender from compensating a person who is required to hold a broker’s license, unless that person is licensed as a broker.
- 5) Prohibits a finance lender from compensating a broker for an act that requires a broker’s license if the finance lender has actual knowledge, at the time compensation is to be made, that the broker has violated any provision of the CFL in connection with that loan.
- 6) Prohibits a finance lender from passing an additional fee on to a borrower that is attributable to a referral fee the finance lender paid or will pay, but clarifies that a finance lender may charge a borrower additional fees or costs attributable to non-lead generation brokering activities, if the finance lender pays another person or entity for performing any of those acts

¹ Companies typically conduct these activities via the internet.

for a loan made pursuant to the CFL.

- 7) For loans related to specified broker activities, requires a finance lender to provide a specified disclosure to each prospective borrower referred to that lender by a broker, and have the prospective borrower acknowledge receipt of that disclosure, before the prospective borrower becomes obligated on the loan.
- 8) Requires a licensed broker to provide a specified disclosure to each prospective borrower and to obtain that prospective borrower's express consent, before transmitting confidential data to a lender.
- 9) Imposes a series of requirements on brokers who compensate unlicensed persons for referrals that would have constituted activities requiring a broker's license, if those referrals had been made to a licensed finance lender, and requires these brokers to develop, implement, and enforce policies and procedures intended to ensure compliance with those requirements, as specified. Among these requirements is a provision intended to ensure that unlicensed persons do not collect confidential data directly from a prospective borrower for the purpose of referring that borrower to a licensed broker, without first obtaining the prospective borrower's express consent for that purpose.
- 10) Provides that nothing in the CFL shall be interpreted to alter federal and state law governing tribal sovereign immunity.
- 11) Clarifies instances when a commercial lender may compensate an unlicensed person for a referral, as specified.
- 12) Establishes a routine exam cycle for CFL licensees of at least once per 48 months and specifies that DBO may examine an affiliate of a licensee to examination if a licensee provides documented evidence of unlawful activity between a licensee and the affiliate.

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)

- CFL 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.

Our state regulator, DBO, has recently brought multiple enforcement actions for unlicensed broker activities, but 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 2017, CFL lenders originated 352,207 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.

Lack of transparency and conflicts of interest

This bill requires a broker to disclose to a borrower whether their compensation from a lender is contingent upon the borrower accepting a loan or whether it varies based on the size of the 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

This bill prohibits a CFL licensee from compensating a broker who is known to have committed any violation of the CFL, including requirements 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

This bill prohibits a broker from performing any act as a broker without first obtaining a consumer's express consent for that purpose. 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) ARGUMENTS IN SUPPORT

A coalition of consumer advocates writes:

This bill would regulate the unlicensed brokering activity that has emerged on the internet as a primary method for high-cost lenders to draw consumers into risky, triple-digit APR loans...Given these companies' role in marketing to consumers - often, to draw them in to costly loans - it is crucial that we update the law to provide clearer oversight of lead generators' activities and obtain better data about industry trends...AB 642 provides helpful clarity to existing law and addresses emerging business models that may pose risk of financial harm to consumers, and it will assist DBO in soundly implementing and enforcing the CFL.

On Deck Capital writes:

As the largest online small business lending platform in the United States, OnDeck uses technology to expand access to capital for America's small businesses...OnDeck believes AB 642 will provide much needed clarity on the treatment of different referral relationship under California law...By providing clear distinctions among brokering and referral activities and allowing certain flexibility in the compensation arrangements permitted thereunder, AB 642 will provide greater legal certainty, create a more level playing field for existing CFL licensees, and open the door for more companies to explore licensure under the CFL.

7) ARGUMENTS IN OPPOSITION

The Online Lenders alliance writes:

We are concerned that if AB 642 is signed into law that much of the innovation that has allowed consumers to have greater and more secure access to lenders and additional lending options would be significantly impaired...OLA-member lead generators are not opposed to regulatory oversight." The letter summarizes a number of concerns about specific requirements in the bill, including the timing of required disclosures and the

entities responsible for providing such disclosures. OLA is concerned that the required disclosures will disrupt the consumer experience, slow down the process, and confuse consumers.

REGISTERED SUPPORT / OPPOSITION:

Support

California Association For Micro Enterprise Opportunity
California League Of United Latin American Citizens
California Low-Income Consumer Coalition
City And County Of San Francisco - Treasurer'S Office
Consumer Reports
Consumers For Auto Reliability & Safety
Housing And Economic Rights Advocates
On Deck Capital

Oppose Unless Amended

Small Business Finance Association

Oppose

Habematolel Pomo Of Upper Lake
Online Lenders Alliance

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