Date of Hearing: April 27, 2015

ASSEMBLY COMMITTEE ON BANKING AND FINANCE
Matthew Dababneh, Chair
AB 1517 Committee on Banking and Finance – As Amended April 16, 2015

SUBJECT: Business

SUMMARY: Updates cross-references and outdated contact information with respect to the Department of Business Oversight (DBO). Specifically, **this bill**:

1) Transfers additional duties from the abolished Department of Corporations (DOC) and the abolished Department of Financial Institutions (DFI) to the DBO and the Commissioner of Business Oversight, as specified.

2) Repeals obsolete provisions relating to the DOC.

3) Makes other clarifying and technical changes.

EXISTING LAW implements the Governor's Reorganization Plan, which combined as of July 1, 2013, the DOC and the DFI to create the DBO. DBO provides the regulation and oversight of state chartered banks and credits unions and money transmitters. Furthermore, DBO is charged with the regulation and oversight of mortgage loan originators, deferred deposit transaction licensees, finance lenders, residential mortgage lenders, escrow agents, securities broker-dealers, and investment advisors.

FISCAL EFFECT: Unknown.

COMMENTS:

AB 1517, an Assembly Banking and Finance Committee bill merely updates and makes needed corrections throughout various code sections.

The changes in the measure include:

1) In Financial Code 1070 (d): Amends the definition of “facility. “Facility,” means an office in this state at which a bank engages in noncore banking business but at which it does not engage in core banking business.

   Under current law, a “facility” only refers to offices of a bank within the state of California. This becomes an issue when a bank wishes to establish a facility in another state or country (foreign facility) or wishes to relocate, redesignate or discontinue an existing foreign facility because current law does not allow a bank to do so, and DBO has no authority over existing foreign facilities.

   Prior to the enactment of AB 1301 (Gaines, Chapter 125, Statutes of 2008) which defined “facility” in the Financial Code, state-chartered banks were able to open offices outside of the state under the supervision of DBO. The inadvertent error in the definition limits the establishment, relocation, redesignation or discontinuance of a facility to just offices and branches in the state of California.

Striking out "in the state" would restore the authority of California state-chartered banks to establish, relocate, redesignate or discontinue facilities in another state or country, and allow the DBO to regulate those facilities. This would eliminate the constraints in current law that only allows a California state-chartered bank to open a facility in California.

2) Repeals Financial Code 1008. Financial Code 1008 restricts the amount of funds a financial institution may deposit in any other financial institution to 10 percent of capital unless the institution has been approved by the commissioner. Generally, well-known correspondent banks receive no limit. Federal Reserve Board Regulation F (12 CFR 206), which is applicable to all depository institutions insured by the Federal Deposit Insurance Corporation (FDIC), also sets limitations on the amount of funds that may be deposited in another financial institution; but does so by requiring a financial institution to adopt policies based upon prudential standards that take into account credit, liquidity, and operational risks. The Federal Reserve Board Regulation F also monitors the correspondent to ensure that the bank's exposure does not exceed internal limits set by the institution, or the regulation's maximum of 25 percent, unless exempted.

   The financial institutions licensed under the DBO are all subject to Federal Reserve Board Regulation F, thus it is unnecessary for DBO to reevaluate these transactions.

   Additionally, the current language in Financial Code 1008 was repealed by AB 1301 (Chapter 125, Statutes of 2008). It seems that the language was mistakenly reinserted during the rewrite of the Financial Code by AB 1268 (Gaines, Chapter 532, Statutes of 2010) into Section 357. SB 664 (Committee on Banking and Financial Institutions, Chapter 243, Statutes of 2011) renumbered the Sections and placed the language in Section 1008.

3) Removal of subsection (b) in Financial Code 18405. Financial Code 18405 (b) an industrial loan company whose certificate has been surrendered or revoked shall, on or before 105 days after the effective date of such surrender or revocation, submit to the commissioner a closing audit report containing audited financial statements as of such effective date for the 12 months ending with such effective date, or for such other period as the commissioner may specify. Such report shall include the information required by subdivision (a) of this section and other relevant information specified by the commissioner. A company which has complied with this subdivision is exempted from the provisions of subdivision (a).

   A premium finance agency is an agency that lends money to an insured party to cover the cost of the premiums paid by insurers. Under current law, a premium finance agency that is surrendering its license must submit an audited financial statement to the DBO as part of the surrender. Non-compliance with this statute is high, since licensees are reluctant to pay for an audited financial statement when they are in the process of exiting the business. The only recourse for the commissioner of DBO is to revoke the license and prepare for a possible administrative hearing, which adds to DBO's regulatory costs.

   Currently, the DBO has 108 premium finance agency licensees. Thirteen premium finance agency licensees are currently in the process of surrendering their licenses. In some cases, the premium finance agencies have ceased doing business. However, the DBO is unable to purge the licensee from its rolls until the audited financial statement is obtained. Failing that, the DBO is required to revoke the license by issuing an order and preparing for an administrative hearing (if requested by the licensee).

4) Amendment to correct error in Corporations Code 25401. Corporations Code 25401 states it is unlawful for any person, in connection with the offer, sale, or purchase of a security, directly or indirectly, to do any of the following:

   a) Employ a devise, scheme, or artifice to defraud.

   b) Make an untrue statement of material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which they were made, not misleading.

   c) Engage in an act, practice, or course of business that operates or would operate as a fraud or deceit upon another person.

   It is unlawful for any person to offer or sell a security in this state or buy or offer to buy a security in this state by means of any written or oral communication which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.

   SB 538 (Hill, Chapter 335, Statutes of 2013) amended the Corporations Code to align certain provisions with federal law. However, one amendment inadvertently raised the burden of proof for civil and criminal litigation for DBO attorneys and local prosecutors who try securities fraud cases. There is additional concern that California courts will begin to rely on the federal interpretation of Rule 10b-5, which requires that plaintiffs prove they relied upon any misrepresentations or omissions made by the defendants. This would provide less protection to consumers since the burden of proof would fall on them and their legal representation.

   The DBO Enforcement Division has received input from district attorneys that their prosecutors will be negatively impacted if current law in Section 25401 under the Corporations Code remains in place.

   The amendment to return to the former wording of Corporations Code Section 25401 in its entirety will return the burden of proof for securities fraud back to its status under long-settled California law for cases involving misrepresentations or omissions of material fact.

5) Amendment to correct the timeframe in which an individual may request a hearing to dispute a desist and refrain order under Corporations Code 29542 (b). Corporations Code 29542 (b) states if after an order has been made under subdivision (a), a request for hearing is filed in writing within one year to 30 days of the date of service of the order by the person to whom the order was directed, a hearing shall be held in accordance with the Administrative Procedure Act (Chapter 5, (commencing with Section 11500) of Part 1 of Division 3 of Title 2 of the Government Code), and the commissioner shall have all of the powers granted under the Administrative Procedure Act. Unless the hearing is commenced within 15 business days after the request is filed (or the person affected consents to a later date), the order is rescinded.

If that person fails to file a written request for a hearing within 30 days from the date of service of the order, the order shall be deemed a final order of the commissioner and shall not be subject to review by any court or agency, notwithstanding Section 29563.

SB 538 amended the California Commodity Law of 1990 to specify the period in which an individual may request a hearing to dispute a desist and refrain order. This bill changed the time period from one year to 30 days in the Corporations Code section 29542(b), however, due to an oversight, there still remains a reference to the one year timeframe.

6) Technical clean-up amendments: changes references to the DOC and DFI to the DBO. Update the powers and responsibilities of DOC, DFI and their respective commissioners to the newly created DBO.

   During the Governor's Reorganization Plan 2 (GRP 2) many laws were updated to reflect the newly created departments. AB 1317 (Frazier, Chapter 352, Statutes of 2013) and SB 820 (Committee on Gov. Org, Chapter 353, Statutes of 2013) executed many of the necessary changes to implement GRP 2, but did not address all of the necessary conforming changes to properly reflect the agencies and departments created as a result. In consequence the law currently still refers to DFI and the DOC, which were eliminated under GRP 2.

REGISTERED SUPPORT / OPPOSITION:

Support

None on file.

Opposition

None on file.

Analysis Prepared by: Kathleen O'Malley / B. & F. / (916) 319-3081

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FISCAL EFFECT: Unknown.

COMMENTS:

AB 1517, an Assembly Banking and Finance Committee bill merely updates and makes needed corrections throughout various code sections.

The changes in the measure include:

1) In Financial Code 1070 (d): Amends the definition of “facility. “Facility,” means an office in this state at which a bank engages in noncore banking business but at which it does not engage in core banking business.

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Striking out "in the state" would restore the authority of California state-chartered banks to establish, relocate, redesignate or discontinue facilities in another state or country, and allow the DBO to regulate those facilities. This would eliminate the constraints in current law that only allows a California state-chartered bank to open a facility in California.

2) Repeals Financial Code 1008. Financial Code 1008 restricts the amount of funds a financial institution may deposit in any other financial institution to 10 percent of capital unless the institution has been approved by the commissioner. Generally, well-known correspondent banks receive no limit. Federal Reserve Board Regulation F (12 CFR 206), which is applicable to all depository institutions insured by the Federal Deposit Insurance Corporation (FDIC), also sets limitations on the amount of funds that may be deposited in another financial institution; but does so by requiring a financial institution to adopt policies based upon prudential standards that take into account credit, liquidity, and operational risks. The Federal Reserve Board Regulation F also monitors the correspondent to ensure that the bank's exposure does not exceed internal limits set by the institution, or the regulation's maximum of 25 percent, unless exempted.

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   Additionally, the current language in Financial Code 1008 was repealed by AB 1301 (Chapter 125, Statutes of 2008). It seems that the language was mistakenly reinserted during the rewrite of the Financial Code by AB 1268 (Gaines, Chapter 532, Statutes of 2010) into Section 357. SB 664 (Committee on Banking and Financial Institutions, Chapter 243, Statutes of 2011) renumbered the Sections and placed the language in Section 1008.

3) Removal of subsection (b) in Financial Code 18405. Financial Code 18405 (b) an industrial loan company whose certificate has been surrendered or revoked shall, on or before 105 days after the effective date of such surrender or revocation, submit to the commissioner a closing audit report containing audited financial statements as of such effective date for the 12 months ending with such effective date, or for such other period as the commissioner may specify. Such report shall include the information required by subdivision (a) of this section and other relevant information specified by the commissioner. A company which has complied with this subdivision is exempted from the provisions of subdivision (a).

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   Currently, the DBO has 108 premium finance agency licensees. Thirteen premium finance agency licensees are currently in the process of surrendering their licenses. In some cases, the premium finance agencies have ceased doing business. However, the DBO is unable to purge the licensee from its rolls until the audited financial statement is obtained. Failing that, the DBO is required to revoke the license by issuing an order and preparing for an administrative hearing (if requested by the licensee).

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