

Date of Hearing: June 22, 2015

ASSEMBLY COMMITTEE ON BANKING AND FINANCE
Matthew Dababneh, Chair
SB 197 (Block) – As Amended June 8, 2015

SENATE VOTE: 36-0

SUBJECT: Finance lenders: commercial loan: referral.

SUMMARY: Allows a licensee under the California Finance Lenders Law (CFLL) to pay compensation to an unlicensed person or company in connection with the referral of one or more prospective borrowers to the licensee. Specifically, **this bill:**

- 1) Permits compensation to be paid, when all of the following conditions are met:
 - a) The referral by the unlicensed person leads to the consummation of a commercial loan between the licensee and the borrower;
 - b) The loan contract provides for an annual percentage rate (APR) that does not exceed 36%; and,
 - c) Before approving the loan, the licensee does both of the following:
 - i) Obtains documentation from the prospective borrower documenting the borrower's commercial status. (Examples of acceptable forms of documentation include, but not limited to, a seller's permit, business license, articles of incorporation, income tax returns showing business income, or bank account statements showing business income); and,
 - ii) Performs underwriting and obtains documentation to ensure that the prospective borrower will have sufficient monthly gross revenue with which to repay the loan pursuant to the loan terms, and does not make a loan if it determines through its underwriting that the prospective borrower's total monthly expenses, including debt service payments on the loan for which the prospective borrower is being considered, will exceed the prospective borrower's monthly gross revenue. (Examples of acceptable forms of documentation for verifying current and projected gross monthly revenue and monthly expenses include, but are not limited to, tax returns, bank statements, merchant financial statements, business plan, business history, and industry specific knowledge and experience. Permits a credit report if the prospective borrower is a sole proprietor or a corporation and the loan will be secured by a personal guarantee.
- 2) Requires the licensee to maintain records of all compensation for a period of at least 4 years.
- 3) Requires the licensee to annually submit information requested by the Commissioner of Business Oversight (Commissioner) in a report.

- 4) Requires a licensee that receives an application for a commercial loan from a prospective borrower who has been referred to that licensee by an unlicensed person or company to provide the following written statement to the borrower, in no smaller than 10-point type, and ask the borrower to acknowledge receipt of the statement in writing: "You have been referred to us by [Name of Unlicensed Person]. If you are approved for the loan, we may pay a fee to [Name of Unlicensed Person or Company] for the successful referral. If you wish to report a complaint about this loan transaction, you may contact the Department of Business Oversight, Division of Corporations at 1-866-ASK-CORP (1-866-275-2677), or file your complaint online at www.dbo.ca.gov."

EXISTING LAW:

- 1) Defines, pursuant to the CFLL, a commercial loan as a loan with a principal amount of \$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. For purposes of determining whether a loan is a commercial loan, the lender may rely on any written statement of intended purposes signed by the borrower. The lender is not required to ascertain that the proceeds of the loan are used in accordance with the statement of intended purposes. (Financial Code, Section 22502)
- 2) Requires each finance lender and broker licensee to file an annual report with the commissioner, on or before the 15th day of March, giving the relevant information that the commissioner reasonably requires concerning the business and operations conducted by the licensee within the state during the preceding calendar year for each licensed place of business. The individual annual reports filed pursuant to this section shall be made available to the public for inspection except, upon request in the annual report to the commissioner, the balance sheet contained in the annual report of a sole proprietor or any other nonpublicly traded persons. A licensee shall make other special reports that may be required by the commissioner. (Financial Code, Section 22159)

EXISTING REGULATION prohibits a licensed finance lender from paying any compensation to an unlicensed person or company for soliciting or accepting applications for loans, except for an employee regularly employed at a licensed place of business of the finance lender, or if the payment is made to a person or company licensed as a real estate broker, a bank, savings and loan association, or any other financial institution exempted from the CFLL. (California Code of Regulations Title 10, Chapter 3, Subchapter 6, Article 4, Section 1451)

FISCAL EFFECT: Unknown

COMMENTS:

Need for the bill:

This bill is co-sponsored by Opportunity Fund and the California Association for Micro Enterprise Opportunity (CAMEO) to remove a competitive disadvantage that applies to CFLL licensees making commercial loans. In doing so, the co-sponsors wish to improve the ability of microlenders to identify underserved small businesses, and help them access credit.

SB 197 would allow CFLL licensees making commercial loans to pay fees for the successful referral of business, thus eliminating their competitive disadvantage in customer acquisition relative to other entities that extend credit to small businesses in California. According to this bill's co-sponsors, companies that are not subject to the CFLL often offer less favorable terms to small businesses than CFLL licensees, but small business borrowers never learn about these more favorable loans, because the CFLL lenders cannot compensate entities to refer business to them.

Background:

The existing CFLL prohibits CFLL licensees from paying any compensation to any person or company that is unlicensed, in exchange for the referral of business. This places CFLL licensees that make commercial loans at a competitive disadvantage relative to their direct competitors, whom are not required to hold CFLL licenses. As described in more detail below, two types of direct competitors that are not required to hold CFLL licenses include merchant advance companies (not required to be licensed under the CFLL, because they are advancing, rather than lending money) and companies that partner with banks (not required to be licensed under the CFLL, because the loans are made under the banks' charters). CFLL licensees may offer better loan terms to businesses than competitors that lack CFLL licenses, but often lose customers to those competitors, because the competitors can compensate those from whom they receive referrals, while the CFLL licensees are prohibited from doing so.

According to small business lending experts, referrals are the single most efficient way for commercial lenders to acquire small business customers. Because general purpose advertising is not targeted, it is very inefficient at reaching customers. Word of mouth is by far the most efficient use of marketing dollars, but is an avenue that is closed off to CFLL licensees by California's regulations.

Non-CFLL Entities:

Merchant Advance Companies: Merchant advance companies that serve small businesses represent the most common form of direct competition to commercial lenders licensed under the CFLL. Unlike commercial lenders, merchant advance companies do not offer loans. Instead, they offer a variety of non-loan financing options, which include cash advance, purchase order finance, accounts receivable finance, or a combination of these. Generally speaking, business arrangements between merchant advance companies and the firms they fund involve the following: The merchant advance company advances a certain amount of money to a business. In return, the business agrees to remit a certain percentage of its future revenue (typically sales receipts) to the merchant advance company until the advance is paid back. Some merchant advance firms purchase future revenue at a discount; others purchase future sales revenue on a dollar for dollar basis, but charge the business a fee for the transaction. Some contracts require that money be repaid on a daily basis; others require different repayment schedules. There is considerable variety in the ways in which advance transactions are set up; with most being structured in ways that do not require a California lending license.

Rent-A-Charter: Companies that offer loans in partnership with banks represent another type of competition to CFLL licensees. Companies that partner with banks to offer loans can often avoid having to become licensed in the states in which the companies operate, because the loans are technically being made by the bank. This so-called rent-a-charter model has several different

variations, but often involves a company that lacks a lending license acquiring customers and underwriting prospective borrowers, referring qualified borrowers to a bank, allowing the bank to lend to those qualified borrowers, and then purchasing the consummated loans from the bank. Because the bank is technically the lender, the company which partners with it is not required to hold a lending license. As such, it is not restricted in its ability to compensate third parties for the referral of business.

Consumer Protections:

California's existing prohibition against payment of referral fees by licensed lenders is intended to protect borrowers, by ensuring that they are not steered to loans with unfavorable terms by unlicensed individuals whose referrals are based entirely on the compensation they generate, and not on the extent to which the loan makes sense for the borrower being referred. SB 197 is designed to eliminate the possibility that referral fees paid to unlicensed individuals will result in predatory lending. The bill allows the payment of referral fees only upon consummation of a loan, and requires all loans for which referral fees are paid to adhere to specified best practices for business lending (verify the commercial status of the borrower, maximum APR of 36%, and underwriting).

Recommended Amendments:

- 1) On page 3, line 12, delete, "plan" and insert "plans"
- 2) On page 3, line 21, delete " prospective commercial"
- 3) On page 3, delete lines 28-33 and insert:

"A licensee that is a finance lender shall provide a prospective borrower, who has been referred by an unlicensed person or company, the following written statement, in 10 point font or larger, at the time the licensee receives an application for a commercial loan, and shall request the prospective borrower to acknowledge receipt of the statement in writing:"

REGISTERED SUPPORT / OPPOSITION:

Support

California Association for Micro Enterprise Opportunity (CAMEO) – Co-Sponsor
Opportunity Fund – Co-Sponsor
3CORE, Inc.
Academies for Social Entrepreneurship
Accion San Diego
California Asian Pacific Chamber of Commerce
California Black Chamber of Commerce
California Disabled Veteran Business Alliance
California Metals Coalition (CMC)
Capitol Impact Partners
CDC Small Business Finance
El Pajaro Community Development Corporation
Genesis LA
Liberty Capital Group

Microenterprise Collaborative Inland Southern California
Mission Asset Fund
National Federation of Independent Business (NFIB)
Nehemiah Community Reinvestment Fund
Northern California Community Loan Fund
Pacific Community Ventures
Small Business California (SB-Cal)
Small Business Majority
TriTech Small Business Development Center
Valley Economic Development Center (VEDC)
West Company
Woman's Economic Ventures (WEV)
2 Individuals

Opposition

None on file.

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