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Department of Financial Protection and Innovation
Legal Division
Attn: DeEtte Phelps, Regulations Coordinator
2101 Arena Blvd.
Sacramento, CA 95834

By e-mail to regulations@dfpi.ca.gov

Re: **Third Draft Text of Proposed Regulations; Debt Collection Licensing Act**
PRO 05-21

Dear Ms. Phelps,

This letter is written on behalf of my client base. I am a California attorney who has been practicing in the area of consumer finance since 1982. My clients include approximately 60 banks, savings banks, California Finance Lenders, California Deferred Deposit Transaction Law lenders, retail installment sellers and retail installment sales financing entities, fintechs, residential solar system providers and financers, servicers of performing portfolios of consumer obligations, and various other entities engaged in offering consumer and commercial financial services.

I do not represent any collection agencies, debt buyers, or other third-party collectors of delinquent debt portfolios. Nonetheless, many of my clients' activities are, *ipse dixit*, subject to regulation under the Debt Collection License Act (the "Act" or the "DCLA"). However, the consumer finance ecosystem is more nuanced than a noncontextual reading of the Act would indicate; this has led to significant misunderstandings, inefficiencies, and the fitting of round pegs into square holes in the implementation of the Act.

For this reason, I welcome both the contents of the current proposed regulation (the "Proposal") and the opportunity to comment on it. In an effort to make it easier to absorb my comments, I will set forth each portion of the text of the Proposal and my comments below it.

Definitions

Proposed Section 1850(d): "Charged Off. *"Charged off means a debt that has been removed from a creditor's books as an asset and treated as a loss or expense."*

Comment: I have no objection to the language of this proposed exemption, but I feel it's too good to be true. This would mean that the standard for determining whether a debt has been charged off is entirely based on the creditor's internal accounting procedures. I don't mind that at all, but I feel it is unlikely that the Department will be willing to adhere to that broadly open-ended standard in all instances. I don't wish to suggest GAAP as an alternative, as I feel that the Department does not have the authority to adopt a standard that is not subjected to the Administrative Procedures Act, such as GAAP, in its regulations. Perhaps the Department could borrow a standard here from the rules or procedures used by the banking side of the Department in its examination of state-chartered banks.

Proposed Section 1850(j): "Employee." *"Employee" means an individual whose manner and means of performance of work are subject to the right of control of, or are controlled by, a person and whose compensation for federal income tax purposes is reported, or required to be reported, on a W-2 form or international equivalent, issued by the controlling person.*

Comment: I understand that this proposed definition reflects the Department's position concerning employees of various licenses, including, for example, finance lenders. However, this position has hitherto been informal rather than regulatory. I object to the second clause of this provision this provision. That objection is based on the fact that the second clause of this provision significantly misstates California employment law. California law generally does require that the determination as to whether a worker is employee is based upon whether the worker's manner and means of performance of work are subject to the right of control of, or are controlled by, another person, who is then characterized as an employer. However, whether the worker's compensation for federal income tax purposes is reported, or required to be reported, on a W-2 form or international equivalent, issued by the controlling person,[1] is ***not*** determinative under California law issue of whether the worker is an employee or independent contractor. Would that it were, from most employers' viewpoints.

From a regulatory viewpoint, it should be irrelevant as how a person whose manner and means of performance of work are subject to the right of control of, or are controlled by, a DCLA licensee is characterized under employment law. Under the doctrine of *respondeat superior*, the licensee is responsible for the conduct of its agents, be they employees or independent contractors. Therefore, the contractual relationship between a licensee and its workers should be of concern to the Department under the DCLA, so long as that relationship is in compliance with California employment law, which this proposed provision is not.

This proposed language also displays a concerning unfamiliarity on the part of the Department with the manner in which modern workforces are managed. Business entities' work is conducted by employees, independent contractors, leased employees, temporary workers, part-

[1] The term "controlling person" has its own specific meaning under various laws administered by the Department, including the California Financing Law and the DCLA. I therefore recommend this term not be used here, to avoid confusion later on.

time workers, probationary, employees, seasonal workers, uncompensated family members, or any combination of the above. That, however, is a business management matter, which is none of the Department's concern, so long as the licensee supervises its panoply of workers in a manner results in compliant business operations. Therefore, I further respectfully submit that this provision is beyond the authority of the Department and impermissible on that basis.

Proposed Section 1850(k): "Engage in the Business of Debt Collection:" *A person engages in the business of debt collection and is required to be licensed pursuant to section 100001, subdivision (a) of the Financial Code if the person (A) engages in debt collection for a profit or gain, and (B) the activity is of a regular, frequent, or continuous nature. Advertising or otherwise offering the service of debt collection for remuneration also constitutes engaging in the business of debt collection.*

Comment: The *de minimus* exception to DCLA licensing set for in this language is a welcome step towards avoiding unintended consequences and unreasonable burdens to entities that are not engaged in the business of debt collection, loan servicing, lending, or other activities that should not be subject to the DCLA. I read this proposed language together with the proposed language of section § 1850.1, reiterating the effectiveness of the Rosenthal Act for the protection of California consumers, to believe that these two proposal sections read together are a laudably reasonable approach to DCLA implementation, and enforcement.

Having said that, I must express some concern about the vagueness of the standard, which provides no guidance as to what an entity must evaluate in order to decide whether it is "engaged in the business of debt collection" for licensing purposes. Similar terms have led to a significant amount of litigation under the FDCPA in determining whether someone is or is not engaged in debt collection. What are the criteria? Number of clients? Number of debtors? Number of calls or communications? Number of lawsuits? Percentage of company/law firm's operations? Percentage of revenue? Percentage of personnel? Percentage of capital expenditure? Over what period of time?

I will therefore regard this language as an indication from the department that there is room for occasional limited, incidental debt collection activities by a lender, obligation holder, or their attorney, without triggering a DCLA licensing requirement in each instance, and will view this language as a preclusive defense in the event of any allegation to the contrary.

Section § 1850.1(a) Scope of Licensing Requirement. *Each exemption in this section is for Debt Collection Licensing Act purposes only. It does not convey or imply an exemption from any part of the Rosenthal Fair Debt Collection Practices Act, the California Fair Debt Buying Practices Act, the California Consumer Financial Protection Law, or any other law.*

Comment: This is a welcome provision, as it pries DCLA compliance apart from operational compliance with the Rosenthal Act and other debt collection protection statutes. Those compliance structures are, and should be regarded as, independent of each other. Any entity, regardless of

whether there is subject to the DCLA, is of course subject to compliance with the Rosenthal Act and other law. This proposed revision clarifies and reinforces that principle.

Section § 1850.1(b): Entity/Employee Licensing. *Employees of a debt collectors and employees of an entity exempted by Financial Code section 100001, subdivision (b)(1), is not subject to licensure under the Debt Collection Licensing Act when acting within the scope of their employment with a debt collector licensed pursuant to Division 25 of the Financial Code, commencing with Section 100000, or with an entity exempted by Financial Code section 100001, subdivision (b)(1). An Employees of a subsidiary and employees of a parent company of a licensed debt collector is not required to be licensed while working on a temporary basis for the licensed debt collector under the direction and control of the licensee.*

Comment: As noted above, the substance of this particular exemption is welcome, but is inconsistent with the general employee exemption structure. A broader worker exemption structure would be more logical; more workable for licenses; and would not in any way adversely affect the Department's ability to examine for compliance with the DLA, nor to enforce the DLA fully.

Section § 1850.1(b): Entity/Employee Licensing. *The licensing exemption in section 100001, subdivision (b)(1) of the Financial Code applies to the listed entity and their employees acting within the scope of their employment only. The exemption does not apply to a parent entity, subsidiary, or to affiliates.*

Comment: Likewise, this is consistent with the conceptual structure of the DCLA, which licenses entities or corporate actors, and not their employees or contractual agents. For that reason, it's unclear that this comment is actually necessary. However, there is often an unfounded understanding among business entities that a license extends to its parent, subsidiary, or affiliate entities; this proposed comment would be helpful in dispelling that misconception

Section § 1850.1(d): Direct Lender Exemptions. *A person collecting debt arising from a consumer credit transaction that meets the following requirements is not required to be licensed under the Debt Collection Licensing Act:*

(1) the person extended credit underlying the debt to finance goods or services it provided; and

(2) in the ordinary course of business, that person uses a licensed debt collector to collect such debt when the debt;

(A) becomes 90 or more days past due or

(B) is charged off as defined in subdivision (d) of section 1850.

Comment: This and the next proposed sections are generally an excellent step in the right direction. We believe that it is unfair, unnecessary, and damaging to California's economy to apply the DCLA broadly to any first-party obligees, or to their agents and assigns. Therefore, we suggest the addition of another subsection, as follows:

"*the person is the purchaser or assignee of the debt and services the debt in the ordinary course of its business*."

This will close the empty loop between debt originators and debt servicers, by adding the third important entity in the consumer credit ecosystem: the loan or debt purchaser that services the debt for its own account.

Section § 1850.1(3): Servicer Exemptions. *A person solely servicing debts that are less than 90 days past due and have not been charged off is not required to be licensed under the Debt Collection Licensing Act.*

(1) For purposes of this subdivision and subdivision (d), a debt is 90 days past due when at least one payment has not been fully paid within 90 days of the date that the payment was originally scheduled to be paid on the debt.

(2) A person is not exempt under this subdivision if the person engages in any of the following practices during the first 90 days after a debt has become past due:

(A) Reports negative payment performance to a credit reporting agency;

(B) Seizes or impair use of collateral; or

(C) contacts debtor's friends, family, or employer because of their relationship with the debtor.

Comment: This also requires some operational clarification:

(1) With regard to proposed subsection 1850.1(3) what happens in the situation in which a creditor is actively negotiating a loan refinance, recasting, modification, or accommodation with the borrower across the 90-day line of demarcation? In this situation, where the creditor is actively working with the borrower, it seems counterproductive to require the creditor to either obtain a DCLA license, or to assign the credit to a third-party DCLA licensee, to proceed with this process. This, it appears, punishes accommodating, consumer-friendly creditors, rather than encouraging them in such conduct;

(2) It is unclear from the language, what happens when a creditor decides to repossess security within the 90 days. Must the creditor then obtain a DCLA license, or assign the debt to a third-party collector?

(3) If the creditor hires a licensed repossessor, who will be exempt from DCLA licensure under p**roposed Section 1850.1(k)** does the creditor lose its DCLA exemption?

(4) We would suggest a *de minimus* exemption here for holders of debt who make a small number of repossessions of security, whether within 90 days or thereafter. Even if that *de minimus* exemption required that the creditor higher, a licensed repossessor, at least for motor vehicles, that would be an improvement over the current draconian portcullis that will fall after 90 days or upon the first emergency repossession.

Proposed Section 1850.1(h): Scope of DCLA Applicability to Attorneys' Activities: *An attorney collecting a debt on behalf of and in the name of a client solely through activities that may only be performed by a licensed attorney is not subject to licensure under the Debt Collection Licensing Act.*

Comment: This language is excessively restrictive. I do not provide litigation services. However, I do occasionally receive requests from clients to open or handle negotiations with delinquent borrowers. My experience has been is often the case that the borrower simply wants to feel that the lender is hearing their side of the story and their particular circumstances, and I have almost always been able to arrive at satisfactory work out agreements with borrowers: both those represented by counsel and those, not represented by counsel. Since the DCLA has been enacted, I've been refusing to do offer that service due to my concern about the licensing requirement. That has caused additional expense to my clients, who then must retain collection counsel. I feel it is also been a disservice and the source of additional expense to the borrowers, because they have been forced into formal proceedings with collection agencies or collection counsel rather than the easier path I have been able to offer.

Therefore, I suggest that this language be rephrased to read as follows:
An attorney licensed to practice in California who provides services to client in connection with the collection of a debt on behalf of and the client solely in the ordinary course of the attorney's practice of law, including contacts and communications with a debtor of the client as permitted by the Rules of Professional Conduct of the State Bar, is not subject to licensure under the Debt Collection Licensing Act.

Proposed Section 1850.1(k): Licensed Repossessors' Exemption*: A person is not subject to licensure under the Debt Collection Licensing Act when acting as a licensed repossession agency under the authority of the Collateral Recovery Act, Chapter 11 of Division 3 of the Business and Professions Code, commencing with § section 7500).*

Comment: As noted above, there is a gap here. If an exempt first-party holder or service of auto debt hires a licensed repossessor instead of a DCLA collector, does the holder or servicer retain its licensing exemption proposed Section 1850.1(e)(2)? Clarification is requested.

Section §1850.71(a)-(d): Document Retention. *[Text of subsections (a)-(d) omitted as unnecessary to this comment letter.]*

Comment: These proposed rules are a little detailed, and will probably need modification overtime. However, they seem generally reasonable: and they are clear.

Section §1850.71(e): Unspecified Document Retention. *Where a record is subject to both this section and the regulations adopted pursuant to Division 24 of the Financial Code, the longer retention period applies.*

Comment: I don't think the DCLA Section has the authority to adopt this provision. The above content may or may not be correct as the statement of law, but the DCLA Section may only promulgate regulations applicable to the DCLA, not to any provision of Division 24, nor to any regulations that may be promulgated under Division 24. I therefore object to this subsection on that basis.

* * *

Thank you very much for the consideration of these comments.

Sincerely,

/s/ *R. P. Soter, Jr.*

R. Paul Soter, Jr.