



January 22, 2019

Via email to regulations@dbo.ca.gov

Department of Business Oversight, Legal Division
Attn: Mark Dyer, Regulations Coordinator
1515 K Street, Suite 200
Sacramento, California 95814-4052

Re: **File No.: PRO 01-18**

Ladies and Gentlemen:

The California Bankers Association (“CBA”) appreciates the opportunity to comment on the notice of proposed rulemaking issued by the Department of Business Oversight (“DBO”) on December 4, 2018 seeking input from interested parties on how SB 1235 (Chapter 1011, Statutes of 2018) (“SB 1235”) should be implemented.

This letter focuses on two aspects of the SB 1235: (1) the definition of “depository institutions,” in the context of the exemption of depository institutions from the application of SB 1235; and (2) the definitions of “recipient” and “person.”

The “depository institution” exemption

By its terms, SB 1235 does not apply to depository institutions, which are defined in the bill as banks, trust companies, and industrial loan companies authorized to do business in California, as well as federal and state savings and loan associations, savings banks and credit unions that are authorized to do business in California. However, the SB 1235 definition of “depository institution” does not include subsidiaries, affiliates and entities otherwise related to depository institutions that are “engaged in the business of making commercial loans [and] doing business under the laws of the United States related to banks and savings associations.”¹ It is CBA’s position that SB 1235 can and should be interpreted to include such regulated entities that are engaged in commercial lending in the definition of “depository institution” such that those entities are exempt from the requirements of SB 1235, and that doing so is consistent with the DBO’s position in a similar context.

The DBO has previously determined that the distinction between consumer lending (to which SB 1235 does not apply) and commercial lending is highly significant. In its Initial Statement of Reasons for Proposed Regulatory Action under the California Finance Lenders Law and The California Residential Mortgage Lending Act Pro 03/13 (the “Pro 03/13 Initial Statement”) the DBO reasoned that, following the financial downturn of 2007–2009, and the enactment of the Dodd–Frank Act, enhanced consumer protections, to be incorporated into the California Finance Lenders Law, were justified.

In contrast, the Pro 03/13 Initial Statement went on to state that, with respect to commercial lending, a nondepository subsidiary of a national bank or a federal savings association should be exempt from the CFLL (Cal. Fin. Code §22000 *et seq.*) “because the lending transactions do not raise the equivalent borrower protection concerns that motivated this regulatory action Further, as highlighted when the Commissioner sought input on this proposal from interested parties, a commercial lender’s status as a

¹ See the DBO’s Statement of Reasons for Proposed Regulatory Action under the California Finance Lenders Law and The California Residential Mortgage Lending Act Pro 03/13, page 7, discussed *infra*.

subsidiary of a federally-regulated depository institution ensures that the primary borrower protections of the commercial lending provisions of the CFLL are satisfied.” (Pro 03/13 Initial Statement, pg. 6).

The Pro 03/13 Initial Statement continued as follows: “The regulatory protections of the CFLL governing commercial lending are in large part unnecessary as applicable to subsidiaries of federal banks and savings associations, given the regulatory protections under federal law. In the Commissioner’s view the oversight by the OCC, as the primary regulator of banks chartered under the National Bank Act (12 USC 1 *et seq.*) and federal savings associations chartered under the Home Owners Loan Act of 1933 (12 USC 1461 *et seq.*), is sufficient to conclude that the nondepository subsidiaries of these financial institutions engaged in the business of making commercial loans are doing business under the laws of the United States related to banks and savings associations.” (Pro 03/13 Initial Statement, pg. 7) (emphasis added).

Examples of the manner in which depository institutions’ subsidiaries, affiliates and related entities are “doing business under the laws of the United States related to banks and savings associations” abound, including the following:

1. Bank holding companies and their bank and nonbank subsidiaries are regulated by the Federal Reserve Board, as follows:
 - a. “Examinations and inspections. The Board may examine or inspect any bank holding company and each of its subsidiaries and prepare a report of their operations and activities. With respect to a foreign banking organization, the Board may also examine any branch or agency of a foreign bank in any state of the United States and may examine or inspect each of the organization’s subsidiaries in the United States and prepare reports of their operations and activities. The Board shall rely, as far as possible, on the reports of examination made by the primary federal or state supervisor of the subsidiary bank of the bank holding company or of the branch or agency of the foreign bank.” (12 CFR §225.5(c)).
 - b. “In general. Subject to subtitle B of the Consumer Financial Protection Act of 2010 [12 U.S.C. 5511 *et seq.*], the Board may make examinations of a bank holding company and each subsidiary of a bank holding company in order to-(i) inform the Board of-(I) the nature of the operations and financial condition of the bank holding company and the subsidiary; (II) the financial, operational, and other risks within the bank holding company system that may pose a threat to-(aa) the safety and soundness of the bank holding company or of any depository institution subsidiary of the bank holding company; or (bb) the stability of the financial system of the United States; and (III) the systems of the bank holding company for monitoring and controlling the risks described in subclause (II); and (ii) monitor the compliance of the bank holding company and the subsidiary with-(I) this chapter; (II) Federal laws that the Board has specific jurisdiction to enforce against the company or subsidiary; and (III) other than in the case of an insured depository institution or functionally regulated subsidiary, any other applicable provisions of Federal law.” (12 U.S.C. §1844(c)(2)(A)).
2. National banks and their operating subsidiaries are regulated by the Office of the Comptroller of the Currency, as follows:
 - a. “Examination and supervision. An operating subsidiary conducts activities authorized under this section pursuant to the same authorization, terms and conditions that apply to the conduct of such activities by its parent national bank, unless otherwise specifically provided by statute, regulation, or published OCC policy, including sections 1044 and 1045 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 25b) with respect to the application of state law. If the OCC determines that the operating subsidiary is operating in violation of law, regulation, or written condition, or in an unsafe or unsound manner or otherwise threatens the safety or soundness of the

bank, the OCC will direct the bank or operating subsidiary to take appropriate remedial action, which may include requiring the bank to divest or liquidate the operating subsidiary, or discontinue specified activities. OCC authority under this paragraph is subject to the limitations and requirements of section 45 of the Federal Deposit Insurance Act (12 U.S.C. 1831v) and section 115 of the Gramm-Leach-Bliley Act (12 U.S.C. 1820a)." 12 C.F.R. § 5.34(e)(3)).

- b. In addition, the OCC has jurisdiction over a national bank's financial subsidiaries as follows: 12 C.F.R. § 5.39(k): "Examination and supervision. A financial subsidiary is subject to examination and supervision by the OCC, subject to the limitations and requirements of section 45 of the Federal Deposit Insurance Act (12 U.S.C. 1831v) and section 115 of the GLBA (12 U.S.C. 1820a)." (12 C.F.R. §5.39(k))

CBA urges DBO to apply the same sound logic it employed in the Pro 03/13 Initial Statement and extend the "depository institutions" exemption in SB 1235 to subsidiaries, affiliates and related entities that are (1) engaged in commercial lending and (2) supervised and regulated in that context by federal banking agencies, on the grounds that existing federal law offers commercial borrowers dealing with those entities sufficient regulatory protection, such that the disclosure requirements set forth in SB 1235 are unnecessary.

The definitions of "recipient" and "person"

CBA also recommends clarifying the definitions of "recipient" and "person" to clearly establish a California nexus. The definition of "recipient" in SB 1235 is "a person" who is presented a specific commercial financing offer by a provider that is equal to or less than five hundred thousand dollars (\$500,000). "Person" is defined as an individual, a corporation, a partnership, a limited liability company, a joint venture, an association, a joint stock company, a trust, or an unincorporated organization. There is no current requirement that a "person" have ties to California.

CBA proposes that DBO interpret "person" by incorporating the concept of "commercial domicile," as such term is used in California Revenue and Taxation Code Section 25120(b), which reads: "'Commercial domicile' means the principal place from which the trade or business of the taxpayer is directed or managed." For instance, the SB 1235 definition of "person" could be revised to read: "'Person' is defined as an individual, a corporation, a partnership, a limited liability company, a joint venture, an association, a joint stock company, a trust, or an unincorporated organization whose commercial domicile (as such term is used in California Revenue and Taxation Code Section 25120(b)) is in California."

If the definition of "person" is not modified to require a connection with California, it is unclear to whom the disclosures required by SB 1235 should be provided.

If you have any questions regarding the content of this letter or would like more information on the same, please do not hesitate to contact us.

Sincerely,

CALIFORNIA BANKERS ASSOCIATION



By: Martha Evensen Opich
Its: Vice President and Association Counsel

cc: Charles Carriere (via email to charles.carriere@dbo.ca.gov)