



STATE OF CALIFORNIA

Department of Business Oversight

GOVERNOR **Gavin Newsom** • COMMISSIONER **Manuel P. Alvarez**

FILE NO: OP 7667

December 20, 2019

Re: Deferred Payment Products

Dear [Requestor]:

[The “Background” section was omitted due to confidentiality granted to the requestor pursuant to California Code of Regulations, title 10, section 250.10.]

Discussion

You request that the Commissioner determine that [the requestor’s] deferred payment products are not consumer loans regulated by the Department under the CFL [California Financing Law (Fin. Code, § 22000 *et seq.*)].

The CFL prohibits a person from engaging in the business of a finance lender or broker without a license from the Commissioner.¹ Under the CFL, a finance lender is defined to include any person who is engaged in the business of making consumer loans or making commercial loans.² A consumer loan is defined as a loan whether secured, by either real or personal property or both, or unsecured,

¹ Fin. Code, § 22100.

² Fin. Code, § 22009.

the proceeds of which are intended by the borrower for use primarily for personal, family or household purposes.³ If [the requestor's] products are loans, they are subject to the CFL.

Definition of "loan"

The CFL does not define the term "loan." However, the Civil Code defines a loan of money to mean a contract by which one delivers a sum of money to another, and the latter agrees to return at a future time a sum equivalent to that which they borrowed.⁴

Under this definition, [the requestor's] products are loans because they consist of a contract (the Terms of Service entered into between the customer and [the requestor]) by which [the requestor] delivers a sum of money to another (here, to the merchant on behalf of the customer), and the customer agrees to pay the money back at a future time.

Forbearance

In your letter, you argue that [the requestor's] products are not loans but similar to a forbearance. However, it is unclear why a forbearance cannot be a loan and, thus, subject to the CFL. In your letter, you highlight the fact that the usury provisions in the California Constitution treat loans and forbearances interchangeably by referring to loans *or* forbearances. Both loans and forbearances are subject to usury provisions. You have not cited any statute or case law exempting a forbearance from the CFL, nor is the Department aware of any.

Factors indicating a "loan" versus "sale"

In your letter, you argue that [the requestor's] products do not have the indicia of loans. While we disagree, we acknowledge that [the requestor's] products also have the indicia of retail installment sales, which are not loans. A retail installment sale is defined in the Unruh Act⁵ as "the sale of goods or the furnishing of services by a *retail seller* to a retail buyer for a deferred payment price payable in installments" (emphasis added).⁶ Only a bona fide sale, subject to a retail installment sale contract, may be the basis of a retail installment sale contract assignment.⁷ While in your letter you suggest that [the requestor's] products should be "unregulated" (citing [deferred payment products offered by other companies] as examples of "unregulated" products), we note that even retail installment sales, are not unregulated but, rather, regulated under a different statutory scheme.⁸ Nevertheless, we limit our analysis to determining whether [the requestor's] products are loans regulated under the CFL.

³ Fin. Code, § 22203.

⁴ Civ. Code, § 1912.

⁵ Civ. Code, § 1801, et al.

⁶ Civ. Code, § 1802.5; *see also* Civ. Code, § 1802.6 [defining retail installment contracts as between a buyer and a seller].

⁷ *See, e.g., Boerner v. Colwell Company* (1978) 21 Cal.3d 37.

⁸ Civ. Code, § 1801 *et seq.*

In determining whether a transaction is a loan or sale, we look at substance over form.⁹ No one factor is determinative. The relevant factors include, but are not limited to the following:

1. The intent of the parties

Whether the parties intended the arrangement to be a loan is a relevant factor.¹⁰ While the [requestor's] deferred payment products are not presented to customers at checkout as loans, both [the requestor] and the customers treat them like loans. Whether they are aware of such at the time of check-out or not, customers who elect to pay with a [requestor] product must apply for funds to pay for the goods they are purchasing from merchants. [The requestor] provides customers its [requestor] Terms of Service, which explains its deferred payment product's terms of lending and payments, and customers are deemed to agree to these terms by using the [requestor] product payment option. [The requestor] is responsible for all credit decisions, financing, administration, and customer service with respect to the deferred payment products.

2. Whether the merchant and third party are closely related or have a preexisting relationship

If the merchant and the party providing the financing are closely related, the third party will be viewed as extending a loan on behalf of the merchant rather than as an arms-length buyer of the installment contract.¹¹ Here, [the requestor] has contracts in place with merchants before the customer has even contemplated a purchase. These merchants are "[requestor] merchants" and will automatically offer financing to their customers. This close relationship between [the requestor] and the merchant, memorialized by a contract that exists before the customer begins a purchase, is indicative of a loan rather than a credit sale.

3. Whether the third party assumes the contract at the point of sale or later

In *Glaire v. La Lanne-Paris Health Spa, Inc.*, the California Supreme Court found that a finance company's practice of purchasing the vast majority of a gym's membership installment contracts at a discount contemporaneously with their execution, without notifying customers of the discount, was functionally equivalent to extending loans directly to the gym's customers at a defined rate of interest.¹² Similarly, [the requestor] has a relationship with the merchants and assumes their customer contracts at a discount contemporaneously with their execution, without notifying customers of the discount.

On the other hand, in *Boerner v. Colwell Company*, a contract with a mortgage company was entered into at the same time that the sales contract was being negotiated and, yet, the court found the transaction to be a credit sale rather than a loan.¹³ *Boerner* should be distinguished though because the

⁹ *Milana v. Credit Discount Co.* (1945) 27 Cal.2d 335, 340.

¹⁰ *Id.*

¹¹ *Glaire v. La Lanne-Paris Health Spa, Inc.* (1974) 12 Cal.3d 915, 924-925.

¹² *Id.*

¹³ *Boerner, supra*, 21 Cal. 3d 37.

question in that case was whether the usury laws applied. If the transaction was a loan, the usury laws would apply.

4. Whether the third party underwrites the transaction in the manner of underwriting a loan

When a third party provides the contract and evaluates the creditworthiness of the customer, such conduct indicates the transaction is a loan.¹⁴ [The requestor] determines if merchants' customers are eligible for funding and agrees to purchase the installment credit sale contracts from the merchants without recourse. However, based on similar facts (the finance company supplied the forms, including credit applications, for the customer to fill out and would make the credit decision), the court in *Boerner* held that the transaction was not a loan.

5. Whether the transaction would be regulated under another law

The court in *Boerner* noted that, even though it found the transaction was not a loan, it would be subject to other laws, such as the Unruh Act.¹⁵ The court found that "regulation of these activities is essential for the protection of the vital interests of the consumer."¹⁶ Therefore, if [the requestor] were to argue it is subject to another statutory scheme, we would consider that a factor weighing in favor of finding that the activity was intended by the Legislature to be regulated under a law other than the CFL. However, [the requestor] does not make that argument.

While we acknowledge that case law, particularly *Boerner*, indicates [the requestor's] products have the indicia of sales, [the requestor's] products meet the Civil Code definition of a "loan" and, thus, we find that the factors weigh in favor of regulating them as loans.

No exemption applies

Finally, your letter contends that [the requestor's] products will be regulated as money transmission in some states but acknowledge that California is not bound by the interpretations of other states. We note that [the requestor] requested and received, in a ___ letter from the Department, an exemption from the California Money Transmission Act.¹⁷ Therefore, to the extent that [the requestor] argues the CFL should not apply because another California licensing scheme applies, we disagree.

Conclusion

[The requestor's] products meet the Civil Code and case law definition of "loans." No exemption applies, nor has a compelling public policy reason been advanced, requiring the Department to refrain from regulating these products under the CFL. Thus, [the requestor] should maintain its CFL license to continue offering its deferred payment products in California.

¹⁴ 8 Ops. Cal. Atty. Gen. 330 (Dec. 23, 1946).

¹⁵ *Boerner, supra*, 21 Cal. 3d at pp. 53-54.

¹⁶ *Id.*

¹⁷ Fin. Code, § 2000 *et seq.*

The conclusions expressed herein are based on the facts and circumstances as described in your letter. The Department reserves the right to revisit any conclusions based upon new information or changed circumstances. Please contact the undersigned at (916) 324-6965 if you have any further questions.

Sincerely,

Manuel P. Alvarez
Commissioner
Department of Business Oversight

By

Sherri Kaufman
Senior Counsel