October 5, 2021

Department of Financial Protection and Innovation
Attn: Sandra Sandoval
300 S. Spring Street, Suite 15513
Los Angeles, California 90013

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

Re: Comments on Proposed Second Rulemaking Under the Debt Collection Licensing Act (PRO 01/21)

Dear Ms. Sandoval:

This letter is submitted by the California Financial Service Providers ("CFSP") as a comment to the Invitation for Comments on Proposed Second Rulemaking Under the Debt Collection Licensing Act (the "DCLA") issued by the Department of Financial Protection and Innovation (the "Department") on August 19, 2021 (the "Proposal"). CFSP is a trade association representing business entities licensed under the Consumer Financing Law ("CF Law"), the California Deferred Deposit Transaction Law (the "CDDTL"), the Money Transmitters Law (the "MT Law"), and the Check Casher's Law. CFSP has been serving our members since 1956, and currently represents over 50 separate business entities holding several hundred licenses issued by the Department. CFSP appreciates the opportunity to comment on the Proposal.

CFSP has previously commented on the Department's proposed regulations to implement the DCLA. Our comments generally focused on the definitional issues that the Department now proposes to address. CFSP therefore expresses our appreciation that the Department is now considering these foundational issues. Our primary interest in this regard is to be sure that our membership is able to understand and evaluate its licensing requirements under the DCLA, and is also able, where possible, to avoid duplicate licensing.

We note in this regard that that the Department's examination under the CFL Law and the CDDTL in particular have historically included attention to collection issues. Thus, our members are accustomed to compliance with the underlying California consumer collection laws, and to being examined for such compliance. We further note that collection issues are not even mentioned in the Department's 2021 CDDTL's Annual Report other than in passing on page 25. We believe that it is certain that if the Department had viewed CDDTL collections as a problem area, this area would have been highlighted: but such is not the case.

As we have previously noted, CFSP members utilize many different business models. Some of our members make loans under the CF Law or the CDDTL, or both. Some only cash checks under the Check Casher's Law. Some only offer money

transmissions under the MT Law. Some engage in all three activities. Once the initial transaction – loan, check cashing, or money transmission – is made, some of our members hold the paper evidencing the transaction and service the paper through final payment. Others transfer the paper, or interests in the paper, to affiliates or to unrelated third parties. Some retain servicing of the obligation when ownership of the paper is transferred; some do not. Some transfer the paper only if the initial transaction has failed and the obligation is delinquent. The point of this is that our members are not what are traditionally considered "debt collectors," but that most of our members do engage in seeking to service or collect on obligations they have originated in the normal course of other licensed businesses. Thus, it is not now obvious as to which of our members, must now apply for licensing under the DCLA.

Because of CFSP's members' wide range of business models, it is imperative that our members understand under which circumstances they need to be licensed under the DCLA. A body of thought has suggested that business entities who do not believe they should be covered by the DCLA should just not file license applications. However, this is not a realistic approach for a California business, because the cost of getting licensed, doing the DCLA annual report, and submitting to an examination every few years is significantly less than the cost of addressing even one inquiry or investigative subpoena from the Department. Thus, absent clear guidance, the Department can expect to receive numerous unnecessary, burdensome, and wasteful DCLA license applications. We do not believe such a result serves either the intent of the DCLA nor the interests of California businesses or consumers. Accordingly, the bulk of this letter will concern itself with requests for clarification in this regard.

In our first comment letter, CFSP raised a number of specific models, which the Department did not address in its second draft regulation. These are the situations for which we have asked for clarification:

(1) A CFL licensee servicing loans it originated under its CFL license and holds. This seems clearly exempt from DCLA licensing;

(2) A CFL licensee servicing loans it purchased from another CFL licensee, or another exempt entity, such as a bank. This appears to be exempt but clarification would be helpful;

(3) A CFL licensee servicing loans for which it purchased servicing from another CFL licensee, or another exempt entity, such as a bank. This appears to be exempt but clarification is necessary since the conclusion is not obvious.

(4) A CFL licensee servicing loans it originated under a CFL license and sold to an SPV with ownership related to that of the CFL. This also appears to be exempt but clarification would be helpful;

(5) Same as #4, above, but the SPV services the loans it purchased from the CFL licensee.

(6) A CFL licensee servicing loans it originated under a CDDTL license. This appears to be exempt but clarification would be helpful;

(7) A CFL licensee collecting on checks it cashed under a Check Casher's permit. This appears to be exempt but clarification would be helpful;

(8) A CFL licensee collecting on failed transactions it made under a Money Transmitter's license. This appears to be exempt but clarification would be helpful;

(9) A CFL licensee servicing obligations it purchased from a non-exempt entity, such as a check casher, CDDTL licensee, or retail seller. This appears to be exempt but clarification would be helpful;

(10) Some CFL's routinely immediately sell their loans to SPV's, and the SPV's then securitize them and sell interests secured by the loans. Some of the CFL's retain servicing, and some transferred servicing to the SPV or to a servicing subsidiary. We believe that an exemption in this situation would be in accordance with the spirit of the DCLA, but clarification would be helpful.

(11) A CDDTL licensee servicing loans it originated under its CDDTL license and holds. In other words, does every CDDTL licensee *also* need a DCLA license?

We accordingly now reiterate our request for guidance as to these models.

In addition, with regard to items (2) – (5) and (9) – (10) above, and for all purposes of this letter, we note that nothing in the DCLA, the Rosenthal Act, or the proposed regulations addresses the situation in which a performing loan is transferred from one entity holding that loan to another entity. However, that kind of transfer is so commonplace as to be possibly the rule rather than the exception. We do not believe that it is the intent of either the DCLA or the Rosenthal Act, nor should it be the intent of the DCLA regulations, to subject a loan purchaser in this situation to licensing or regulation under the DCLA. Such a result would be unreasonable, unnecessary, and an example of the unreasoning overregulation of ordinary and reasonable business activity and will serve no useful purpose. Thus, we urge the Department not to adopt such an interpretation of either the DCLA or the Rosenthal Act, and we will provide specific comment and illustrations in this area, below.

Next, we address the potential topics for rulemaking posed by the Department:

I. Scope of the DCLA

A. Definition of Terms:

We believe that certain terms are unclear in their application under the DCLA. While these definitions are consistent between the DCLA and the Rosenthal Act, they are circular and incomplete as they apply to myriad transactions in the real world. The definitions at issue are "consumer credit transaction," "debt collection," and "debt collector."

We believe that the term "consumer credit transaction" was intended under the Rosenthal Act to describe a situation in which a consumer enters into a contract under which (1) the consumer receives money, goods, or services from a business entity and (2) agrees to make payment for that benefit at some future date. We believe that the term "debt collection" was intended under the Rosenthal Act to apply to a situation in which the consumer has not made payment for that benefit in accordance with the contract, and the debt is delinquent or in default, as those terms are generally understood or defined. We believe that the term "debt collection" was intended under the Rosenthal Act to apply to a person who seeks to obtain payment for that delinquent or defaulted contractual obligation: whether that person is the original creditor; a third party engaged for that purpose by is the original creditor; or a third party to whom is the original creditor has transferred its rights under the original contract.

We do not believe that the intention of these definitions of the Rosenthal Act or of the DCLA was to apply to broader sources of consumer payment obligations. Accordingly, we believe the source or nature of the transaction from which the debt arises relevant to this determination. We further do not believe that these definitions were intended to apply to normal debt or payment processing activities of creditors, loan servicers, or other persons seeking to collect contractual payments where there is no material delinquency or default under the underlying consumer credit transaction.

Thus, we believe it is an overreach for the Department to require licensing under the DCLA for various categories of business entities who engage in servicing or collections of payments for obligations that are either (1) not contractually in default, or (2) for which the payment default is incidental to the original underlying transaction. As an example of the first, we offer a consumer lender or consumer loan servicer that is administering a consumer loan agreement for which the consumer has made payments in a manner that is substantially consistent with the loan agreement; no notice of default has been provided to the consumer; the loan is not regarded by the lender or servicer or its regulators or investors as non-performing; and no report of nonpayment has been provided to a consumer credit reporting agency. As an example of the second, we offer the situation in which a business entity that is not primarily in the business of extending consumer credit with regard to the type of transaction for which the entity to whom money is owed is seeking to collect amounts owed to it from a failed transaction in that other transaction. This should include collection of checks returned unpaid to a business that accepted a check as payment for such a transaction by which money, goods or services were provided to the consumer. Other examples applicable to specific business abound. The point is that the DCLA should not be interpreted to make the DCLA and the Department the arbiters of businesses entities' efforts to resolve all failed payment transactions with consumers. Rather, the DCLA should be applied to its original legislative purpose: the licensing of entities engaged in the collection of delinquent or defaulted consumer debt.

2. The DCLA states that "[n]o person shall engage in the business of debt collection in this state without first obtaining a license pursuant to this division." Are regulations needed to clarify the term "engage in the business of debt collection"?

Yes. As noted above, DCLA licensing should be limited to its original intent: the collection of overdue obligations arising out of transactions specifically relating to contracts under which the consumer (1) receives money, goods, or services from a business entity and (2) agrees to make payment for that benefit at some future date.

3. The DCLA defines a debt collector as "any person who, in the ordinary course of business, regularly, on behalf of that person or others, engages in debt collection." Are regulations needed to clarify the term "in the ordinary course of business" or "regularly"?

Yes. As noted above, DCLA licensing should be limited to its original intent: the regulation of persons engaged in the collection of overdue obligations arising out of transactions specifically relating to contracts under which the consumer (1) receives money, goods, or services from a business entity and (2) agrees to make payment for that benefit at some future date.

4. Financial Code section 100001, subdivisions (b)(1) and (c) provide exemptions from the DCLA. Is further clarification needed regarding which entities or transactions are exempt?

Yes. As noted above, the language setting forth the exemptions is brief and unnuanced, and fails to address numerous common modern business models. The questions set forth above, at a minimum, should be addressed in the regulations. After all, to large extent, the purpose of regulations is to fill in gaps left by legislation. In addition, the Department should establish a mechanism under which business entities can request and obtain expeditious and reliable guidance as to whether specific models do or do not require licensing under the DCLA.

5. The DCLA defines a "debtor" as "a natural person from whom a debt collector seeks to collect a consumer debt that is due or owing or alleged to be due or owing from the person." Is the term "due or owing" clear?

No, that term is not clear. As noted above, we believe that the term "debtor" was intended under the Rosenthal Act to apply to a consumer from whom payment is sought for a delinquent or defaulted contractual obligation. Thus, we believe "due and owing" should be interpreted to mean, "delinquent" or "defaulted." It might be useful for the regulation to provide specific guidance in that regard, as suggested above: e.g., the consumer has not made payments in a manner that is substantially consistent with the loan agreement; a notice of default has been provided to the consumer; the loan is regarded by the lender or servicer or its regulators or investors as non-performing; a report of nonpayment has been provided to a consumer credit reporting agency.

6. The DCLA grants the Department authority to enforce the Rosenthal Act and the FDBPA against persons required to be licensed under the DCLA and persons expressly exempt from licensure, including certain federally- regulated entities. Is further clarification needed regarding against whom the Department can enforce the Rosenthal Act and the FDBPA?

Yes. Implementation of the suggestions set forth above will largely address this issue. In addition, the Department should address the double-licensing issues applicable to the persons addressed above, and to other entities such as pawnbrokers, to insure that an entity engaged in offering consumer financial service will not face duplicative regulation and examination in the extension and servicing of credit under its other licenses.

II. Annual Reports

As a preliminary matter here, CFSP will, of course, want to know what information the Department wants, and to what use that information will be put. Our experience has been that the primary purpose of licensee reporting seems to be for compilation into reports by the Department, which reports are then seldom, if ever, used as the basis for policy by either of the Department or the Legislature. If there is information that the Department would like to see in DCLA reports, to affect a specific purpose under the DCLA, CFSP will work vigorously with the Department to facilitate and effect the most efficient compilation and collection of that information. However, CFSP deplores any tendency for the collection of information solely for the purpose of filling boxes and beefing up the volume of reports.

1. What terms in Financial Code section 100021 need clarification and how should those terms be defined?

The following terms need clarification:

- "Debtor Accounts" – The list starts with a puzzler. "Account" is not defined by either DCLA or the Rosenthal act. Does this mean the total number of DCLA-covered consumer credit transactions being serviced or collected by a licensee? Or does it mean the total number of consumers for whom consumer credit transactions being serviced or collected by a licensee? Or something else? Again: what is the purpose for which this information is sought? How can that purpose most efficiently be served? And, again, what transactions are covered by DCLA in the first place?
- "Accounts Purchased" and "Accounts 'collected on'" – These two items seem to be intended to be read together to distinguish among two models for collection of delinquent and defaulted debts: (1) outsourcing of collections with debt ownership retained by the original creditor, and (2) sale of delinquent and defaulted debt obligations to collection entities. CFSP has no objection to this information, provided that the Department can articulate a purpose for its use.
- "The face value dollar amount of California debtor accounts in the licensee's portfolio in the preceding year" – This item goes back to the discussion above as to what debt is covered by the DCLA. Does it include debt that has always been performing, and is merely being serviced? CFSP submits that such information would be meaningless for DCLA purposes; burdensome to licensed lenders and other businesses that may happen to hold debt due to the failure of transactions that were not intended to be covered by the Rosenthal Act or the DCLA; and should not be subject to double licensing or regulation under the DCLA. Alternatively, does this item refer solely to delinquent and defaulted debt obligations? That would seem to make more sense, although, again, CFSP would like to see that the Department articulate a purpose for its use.
- "The total dollar amount of California debtor accounts collected in the preceding year" – Again: what does this refer to, and what is its purpose? Does it include debt collected by licensed entities, or entities not required to be licensed, that has been paid as agreed under an initial contract (such as a CDDTL or pawn loan); paid as agreed after a failed initial transaction (such as a check returned NSF to a merchant); or paid as agreed after a successful initial transaction (such as an installment sale by a merchant? Or does this refer only to delinquent and defaulted debt obligations? If the latter, does that apply to both first-party and third=party creditors? And, again, to what use will this information be put?
- "The total dollar amount of outstanding debt that remains uncollected [in the preceding year]" – Again: this information, its meaning, use, and burdensomeness level, is entirely dependent on the definitional and coverage determinations discussed above. Is this intended to be a compilation of all debt servicing by entities not exempt from the DCLA? That would include all outstanding balances on debt obligations – however defined, performing or non-performing, delinquent or current. Or is it intended solely to apply to the collection of delinquent and defaulted debt obligations?
- "The total dollar amount of net proceeds generated by California debtor accounts in the preceding year" – Again: this information, its meaning, use, and

burdensomeness level, is entirely dependent on the definitional and coverage determinations discussed above. Is this intended to be a compilation of all debt servicing by entities not exempt from the DCLA? Or is it intended solely to apply to the collection of delinquent and defaulted debt obligations?

- "Whether or not the licensee is acting as a debt collector, debt buyer, or both." – What if the licensee is a first-party creditor collecting on its own debt? If that entity is required to be licensed, then that information should be compiled to more fully and accurately evaluate and report on the effect and burden of the DCLA on California business entities.

The Department's attention is also drawn to subsection 1000021(d): "A licensee shall make other special reports that may be required by the commissioner." CFSP urges the department to adopt and implement a rule of reason with regard to this provision. Unfortunately, over the past several years, the Department has often on more than one occasion peremptorily demanded reports from licensees pertaining to matters as to which licensees had no previous notice, and therefore had not been compiling the information sought by or demanded by the Department. Further, these reports were typically demanded on short time frames and in formats that were not always possible for licensees to produce. While the Department's staff may have no current intention of engaging in such practices with regard to the DCLA, CFSP members remember these unfortunate incidents and do not wish recurrences. We feel that the best way to prevent such overreach by the Department in the future is for the regulations to specifically provide that any supplemental reports must be based only on information that the licensees have previously been directed to collect, or are in formats which licensees can reasonably provide on short time frames.

1. Is there additional information the Department should require from licensees in their annual reports?
   No.

III. Higher Bond Amounts

1. Should the Department require higher bond amounts pursuant to Financial Code section 100019, subdivision (e)(2)?

No. CFSP's members' experience has been that bonds are seldom, if ever, the subject of recourse actions by the Department or any other government or private entity. While a bonding requirement may be a reasonable entry barrier to establish some level of financial responsibility, licensees' bonds have not been significant licensee management tool, and the Department should learn from and implement its experience in that regard.

2. If the Department should require higher bond amounts, what amounts are appropriate and how should they relate to the number of affiliates under the license and the dollar amount of consumer debt collected by the licensee? Specifically:

1. At what point should the bond amounts begin to increase?
2. What formula is appropriate for calculating the higher bond amount?
3. Should the amounts be set based on tiers? If so, what should be the boundaries between the tiers?

If the Department considers this, it should set incremental bond requirements at low levels and revisit those requirements once it has experience to justify any such higher amounts. At the moment, neither the Department nor anyone else has any data on which to base such requirements.

One additional operational issue that we have previously noted is that the proposed regulation requires a DCLA-licensed entity to obtain permission from the Department to engage in collection activities under a fictitious business name. However, the Department has not addressed whether existing fictitious business names are grandfathered: i.e., whether an entity that has been using a fictitious business names must stop using it until the DFPI approves it. We request the Department to approve such continued use of existing fictitious business names, as to jam the brakes on such activities on a statewide basis will be highly disruptive to lawful, publicly registered, overt, and previously fully compliant business activities.

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CFSP reiterates our appreciation for the consideration of these comments by the Department.

Sincerely,

[redacted]

Thomas Leonard
Executive Director
California Financial Service Providers