

September 17, 2021

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

By Electronic Mail: regulations@dfpi.ca.gov
With Copies To: Colleen Monahan,
[REDACTED] [@dfpi.ca.gov](mailto:[REDACTED]@dfpi.ca.gov)

Re: **[Comments on Proposed Rulemaking Under the California Consumer Financial Protection Law: Commercial Financing to Small Businesses, Nonprofits, and Family Farms \(PRO 02-21\)](#)**

Dear Ms. Sandoval:

On behalf of Strategic Funding Source, Inc., doing business as Kapitus (Kapitus), we would like to thank the Department of Financial Protection and Innovation (DFPI) for the opportunity to provide the following comments on the proposed rules relating to the implementation of AB 1864. These comments relate to DFPI's proposed definitions of unfair, deceptive, or abusive acts and practices in connection with the offering or providing of commercial financing or other financial products and services to small business recipients, nonprofits, and family farms.

Kapitus provides capital to small business through technology-enabled underwriting and currently offers two products in California. First, Kapitus originates commercial loans under a CFL license. In addition, Kapitus enters into contracts with small businesses where it purchases a percentage of a small business's future income. Unlike business loans provided by many traditional lenders and the Small Business Administration, Kapitus' business financing options allow business owners to use their funds for any business purpose. This flexibility has been particularly helpful to business owners during the COVID-19 pandemic in addressing disruptions in cash flow and liquidity. Given the nature of Kapitus' business, it would be subject to the regulations outlined in the draft language accompanying the captioned invitation for comments.

While the DFPI's draft regulations provide a broad framework for unfair, deceptive, or abusive acts or practices, as described below, the regulations introduce significant regulatory uncertainty for businesses providing financial products and services to small business recipients, nonprofits, and family farms. Uncertainty of this type can

inhibit innovation and flexibility in connection with the offering of new financial products or services.

Section X.90009.1(a)(1) Unfair Acts or Practices

Of the definitions enumerated in the draft regulations, the definition of unfairness is perhaps of greatest concern, because it enumerates four disjunctive standards that are quite broad and/or vague. For example, the draft regulations provide that an act or practice is unfair if it “offends an established public policy, or the act or practice is immoral, unethical, oppressive, unscrupulous, or substantially injurious to a person.” Reasonable minds will certainly differ on questions of morality and ethics, leaving to the DFPI significant and perhaps nearly unfettered discretion to unilaterally declare as unlawful certain acts or practices that are commonplace. As such, Kapitus recommends that the DFPI excise this factor and delete Section X.90009.1(a)(1)(C).

In addition, the draft regulations provide that any act or practice that “violates another law” shall be an unfair act or practice without any assessment as to whether the alleged act or practice caused injury to a consumer. As recently as this term, the United States Supreme Court has made clear that a claim for damages cannot be supported if a consumer does not suffer a real harm and the risk of future harm never materializes. See *TransUnion LLC v. Ramirez*, No. 20-297, 2021 WEL 2599472, -- S.Ct. – (2021). In the *TransUnion* case, the Court concluded that an action against TransUnion could not move forward in a case where 6,000 putative class members’ credit reports contained an unlawful inaccuracy, but those reports were not published to any third party. In the context of these regulations, declaring an act or practice as “unfair” simply because it technically violates any law opens the floodgates. As such, Kapitus recommends that the DFPI excise this factor and delete Section X.90009.1(a)(1)(A).

With these recommended excisions, the draft regulations would be left with a standard that is essentially identical to the regulations promulgated by the Consumer Financial Protection Bureau (CFPB) in its examination manual. In particular, the CFPB regulations provide that for an act or practice to be unfair, it must

- Cause or be likely to cause substantial injury to consumers;
- Cause an injury that consumers are not reasonably able to avoid; and
- Cause an injury that is not outweighed by countervailing benefits to consumers or competition.

See CFPB UDAAP Manual at 1-2, available online at https://files.consumerfinance.gov/f/documents/102012_cfpb_unfair-deceptive-abusive-acts-practices-udaaps_procedures.pdf.

Section X.90009.1(a)(2) Deceptive Acts or Practices

Like the definition of unfairness, the DFPI’s draft regulations on deceptive acts and practices should be revised to more closely track long-standing federal and state guidance. The current draft regulations provide that an act or practice is deceptive



“if a small business, nonprofit, or family farm is likely to be deceived by the act or practice.” Under long-standing consumer protection guidance and jurisprudence, deception claims generally require the following:

- A representation, omission, act, or practice that misleads or is likely to mislead;
- The interpretation of the representation, omission, act, or practice is reasonable under the circumstances; and
- The misleading representation, omission, act, or practice is material.

See *id.* at 5. The presence of all of these conditions is important in enumerating a deception standard, because each condition is a critical component in assessing whether a small business, nonprofit, or family farm has been injured. If a small business, nonprofit, or family farm was misled by a disclosure that was immaterial, then such a miscommunication should not form the basis of a deception claim under the law. As such, Kapitus recommends that Section X.90009.1(a)(2) be revised as follows:

(2) An act or practice is deceptive and may not be engaged in by a person offering or providing commercial financing or other financial products or services if:

(A) A representation, omission, act, or practice misleads or is likely to mislead a small business, nonprofit, or family farm;

(B) A small business, nonprofit, or family farm’s interpretation of the representation, omission, act, or practice is reasonable under the circumstances; and

(C) The misleading representation, omission, act, or practice is material.

Section X.90009.1(a)(3) Abusive Acts or Practices

The DFPI’s definition of abusive acts or practices largely tracks the standard enumerated by the CFPB under the Dodd-Frank Act. The CFPB has recognized, however, the difficulty with the scope and meaning of its abusiveness standard, noting in a press release last year that “this uncertainty [of the scope and meaning of abusiveness] creates challenges for covered persons in complying with the law and may impede or deter the provision of otherwise lawful financial products or services that could be beneficial to consumers.” See CFPB Policy Regarding Prohibition on Abusive Acts or Practices (January 24, 2020), available online at <https://www.consumerfinance.gov/about-us/newsroom/cfpb-announces-policy-regarding-prohibition-abusive-acts-practices/>. The CFPB leadership rescinded this guidance in March 2021 based on concerns that “the principles set forth in the Policy Statement do not actually deliver clarity to regulated entities.” See CFPB Statement of Policy Regarding Prohibition on Abusive Acts or Practices, available online at https://files.consumerfinance.gov/f/documents/cfpb_abusiveness-policy-statement-consolidated_2021-03.pdf. Because there still is a lack of clarity in the CFPB standards at the federal level, Kapitus recommends that rather than tracking



language that provides for an unclear standard, that the DFPI provide further guidance to providers of commercial financing to ensure they are meeting clear standards.

Additional Considerations

DFPI's newly broadened discretion under the outlined UDAAP regulations may introduce great uncertainty about how current compliance frameworks may need to be adjusted in California despite no meaningful changes in underlying substantive requirements under the CFL. The CFL currently outlines limits on a range of terms and costs for financial products and services (and penalties for violations), but the DFPI has not committed, in its draft regulations, that it will not separately use its UDAAP authority in a manner inconsistent with current law and regulations.

Kapitus recommends, to avoid confusion and to promote clarity for licensed entities, that the draft regulations be updated to provide a "safe harbor" for acts or practices that are lawful under the CFL. Further, updates to the CFL should be specifically outlined in the CFL to provide uniform and understandable compliance expectations.

In sum, Kapitus supports fair practices to small businesses. In support of these small businesses, Kapitus is continuing to provide innovative and flexible financial products and services and requests regulatory certainty in order to ensure that it can continue to do so.

Kapitus would like to thank the DFPI for taking the time to receive and review its comments. Kapitus looks forward to working with the DFPI on this proposed rulemaking. If the DFPI has any questions or needs additional information, please feel free to contact me.

Sincerely,

MICHAEL JESSE CARLSON

Senior Vice President and General Counsel

