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August 8, 2022

Commissioner of Financial Protection and Innovation
Attn: Sandra Sandoval, Regulations Coordinator
300 South Spring Street, Suite 15513
Los Angeles, CA 90013

Via Electronic Mail to: regulations@dfpi.ca.gov
cc: Samuel.Park@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 the Electronic Transactions Association ("ETA"), the leading trade association for the payments industry, we appreciate the opportunity to provide comments on the Department of Financial Protection and Innovation's ("DPFI") second proposed regulations related to commercial financing of small businesses, nonprofits, and family farms (the "Proposed Rule"). The Proposed Rule includes key changes to more closely align with state and federal UDAAP standards, which are immensely helpful to members' efforts to consider UDAAP risks while designing and offering commercial financial products and services. Notwithstanding those improvements, the ETA has additional significant concerns and suggestions to improve the Proposed Rule.

The DFPI fuses consumer and commercial financing in the Proposed Rule.

In the Initial Statement of Reasons, The Department tries to connect lending to consumers with lending to organizations by claiming these organizations are "managed and operated by individuals and consumers of financial products and services just like individual consumers." This is not backed up by any analysis or research, and it skips over the corporate form entirely as well as the legal and practical distinctions between business organizations and the individuals who own those organizations. Commercial borrowers are, by definition, more sophisticated and distinct from the average consumer borrower. To conflate these two and apply consumer regulations to commercial entities is a clear overstep.

The Proposed Rule Will Not Address Any Instance of Discriminatory Action

The Department stated in their Initial Statement of Reasons that, "The benefits anticipated from this proposed regulation include an increase in consumer welfare, fair competition, and wealth creation in California. The proposed regulation will promote nondiscriminatory access to financial products and services that are not unfair, deceptive, or abusive. Protection from unfair, deceptive, and abusive conduct not only promotes the welfare of California residents but also fosters fair competition among businesses. The proposed regulation is also expected to increase accountability and transparency in the marketplace, which strengthens consumers' confidence and financial stability, which is essential for building wealth." Again, this is provided without any evidence or research to back up the statements that there has been

an issue of discriminatory access or any issues related to fair competition within the state due to UDAAP in commercial financing products and services.

The Proposed Rule would create novel authority to allege UDAAP violations based merely on a proposal to engage in a business activity, without any acts in furtherance of that proposal.

Section 1061(a) of the Proposed Rule features a provision to make it "unlawful for a covered provider to engage, have engaged, or *propose to engage* in any [UDAAP]." (emphasis added). This new provision seems to prohibit communicating about a potential UDAAP, even without any act in furtherance of the proposed act or practice. If this provision is adopted, providers could unknowingly violate UDAAP merely by proposing a new product or feature (e.g., via internal communications) before or even in the process of determining whether the new product or feature would qualify as a UDAAP under law. The ETA feels strongly that its members should have the freedom to propose business ideas in pursuit of innovation without fear of any regulatory consequences. Simply put, the DFPI should not have a draconian authority to pursue violations based on speech alone. This authority does not exist in the FTC Act or the Dodd-Frank Act, and it should be removed from the Proposed Rule.

The provision for determining who is a covered California company should include a safe harbor.

To identify which customers are covered by the Proposed Rule, Section 1060(c) would require our members to determine whether "activities are principally directed or managed from California." This provision goes on to say that providers may rely on "relevant written representations" by the customers, including a business address provided in any application or agreement for the product or service. The DFPI should go further to include a safe harbor for providers that rely on customers that specifically represent their "activities are principally directed or managed from California." This approach would provide certainty and relieve providers from the burden of a potentially complex analysis to determine where customers principally operate.

The Proposed Rule would create confusing and burdensome annual reporting obligations.

The Proposed Rule's applicability to "other financial products or services" would create confusing reporting burdens without any clear policy benefit. While the Proposed Rule now clarifies that the terms “financial products and services” align to the same terms defined in Financial Code section 90005(k), even the clarified definition will be extremely difficult to apply with respect to the proposed annual reporting requirements. Specifically, the reporting obligations in Sections 1062(b)(2)-(4) would require submission of the following information:

- total number and total dollar amount of transactions with covered consumers;
- number of transactions with covered consumers based on multiple tiers of amounts financed; and
- minimum, maximum, average, and median total cost of financing expressed as an annualized rate.

Application of these reporting requirements to certain "other financial products or services" would lead to meaningless data. For example, “other financial products or services'' may include products and services (e.g. financial data processing) that do not result in a "total number and total dollar amount of transactions" requested in Section 1062(b)(2). Similarly, "other financial products and services" conceivably includes payment processing activity, which has nothing to do with the "amounts financed" requested in Section 1062(b)(3) or the "costs of financing" requested in Section 1062(b)(4). Also, providers may design or identify products differently than competitors, in which case the reported transactions and amounts would not be comparable or useful for interpreting market trends. Finally, in light of the complexity and recurring burden associated with these reporting requirements, the Proposed Rule does not indicate why DFPI needs such a broad data set, or whether that data could be released to the public.

The requested commercial financing data would require significantly further definition for providers to be able to comply and to be able to provide information that can be consistently interpreted by the DFPI. The effective date in this section should be amended so that it does not go into effect until after the DFPI finalizes a reporting form with associated definitions for the requested commercial financing data. The DFPI should then publish a proposed reporting form with associated definitions for comment. Our comments above highlight just a few of the challenges with the undefined or vaguely defined terms within the current proposed text.

Covered Provider Definition

1061 (a) It is unlawful for a covered provider to engage, have engaged, or propose to engage in any unfair, deceptive, or abusive act or practice.

These definitions were copied directly from DFA. The DFA UDAAP definitions were drafted for consumers, not commercial entities. Forcing "commercial borrowers" into the definitions and the framework set up by DFA ignores the purpose of UDAAP.

1062 (a) (1) A covered provider who makes no more than one commercial financing transaction to covered consumers in a 12-month period or any covered provider who makes five or fewer commercial financing transactions to covered consumers in a 12-month period that are incidental to the business of the covered provider relying on this exemption.

Would recommend a higher threshold here. In other CA bills and in other states, this is normally capped at 5.

Covered Consumer Definition

(c) (1) “Covered consumer” means a small business, nonprofit, or family farm whose activities are principally directed or managed from California.

As stated, consumer and commercial financing are two completely distinct groups. To conflate consumers and commercial borrowers blatantly ignores the legal and practical distinctions that exist between the two. Indeed, we believe it is confusing to use the term “consumer” when describing “a small business, nonprofit, or family farm” since these are commercial entities, and this regulation is intended to regulate commercial financial products and services. To eliminate this confusion, we recommend changing “covered consumer” to “covered entity” and replacing “covered consumer” with “covered entity”

throughout the regulations. This is a more accurate term to describe "small business, nonprofit, or family farm."

Financial Product or service Definition

1060(f)- (f) "Financial product or service" has the same meaning as in Financial Code section 90005, subdivision (k), except that "consumer" in such definition also includes corporation, business trust, partnership, proprietorship, syndicate, limited liability company, association, joint stock company, and any other organization or legal or commercial entity and "consumer financial Page 2 of 3 PRO 02-21 Text product or service" in such definition also includes a financial product or service that is offered or provided for use primarily for other than personal, family, or household purposes.

We believe it is confusing to conflate the definitions of consumer and commercial, especially when this regulation is intended to regulate commercial entities. To provide clarity and reflect the intent of the regulations, we recommend the following revision:

> "Financial product or service" has the same meaning as in Financial Code section 90005, subdivision (k), except that "consumer" in such definition should be replaced with "covered entity." [Delete rest of definition.]

The Proposed Rule's "small business" definition should be modified to avoid unduly burdensome reporting obligations while preserving the Proposed Rule's purpose.

As currently drafted, the scope of the reporting requirements for "small businesses" under section 1062(b) of the Proposed Rule would be overly burdensome for covered providers to administer and should be modified in a way that preserves the purpose of the proposed reporting requirements. As proposed, covered providers would be required to report certain aggregate data regarding commercial financing (and other financial products or services) provided to "covered consumers," which sections 1060(c)(1) and 1060(h) of the Proposed Rule define to include any "small business" as defined under Code of Civil Procedure section 1028.5, subdivision (c). This "small business" definition – which is drawn from an unrelated provision relating to civil actions between certain entities and state regulatory agencies – relies on information that covered providers typically do not receive from their business customers. For example, whether a business customer qualifies as a "small business" would turn on a determination of whether the customer is "independently owned and operated" and "dominant in its field of operation" (terms that are not defined in the relevant underlying provision) or whether its "annual gross receipts" exceed certain dollar thresholds based on the "category" of the customer's business activity (e.g., "general construction" vs. "specific trade construction"). Covered providers currently often do not have access to information regarding business customers' annual gross receipts or the category of their business activity, and covered providers are not in the business of making determinations about whether their customers are "dominant" in any "field of operation." If covered providers were required to report transaction data under section 1062(b) based on determinations as to whether their business customers are "small businesses" under this definition, covered providers could be required to both collect substantial additional information from business customers that these customers would not otherwise have to provide, as well as make determinations about which entities are "dominant," which would be entirely out of line with a covered provider's core competencies and business models.

As a result, we request that the scope of proposed section 1062(b) be modified to reduce what would be an unreasonable administrative burden on covered providers. We suggest that the scope of proposed section 1062(b) be modified in the following ways:

- At a minimum, covered providers should not be required to determine whether business customers are "dominant" in any "field of operation" or are "independently owned and operated" – and the "small business" definition should be modified to remove these components.
- In addition, the "small business" definition should not include different quantitative thresholds based on the category of the entity's business operations – rather a single threshold (if any) should apply to all customers.
- To minimize any requirement that covered providers solicit additional (and otherwise unnecessary) data collection from customers, covered providers should be given the option to calculate any annual gross receipts component of the "small business" definition based only on income data for the business customer that the covered provider may use (if any) in its commercial financing underwriting process.
    - For example, if a "small business" was generally defined as a business with annual gross receipts of, say, $1,000,000 or less, covered providers would be given the option to alternatively categorize any business customer as a "small business" for these purposes if the covered provider based its commercial financing underwriting decision on annual income data for the business customer of, say, $500,000 or less. In that scenario, if a business customer obtains $15,000 of commercial financing from a covered provider and the covered provider makes its underwriting decision in part based on information indicating that the business customer has annual income of $300,000, then the covered provider could categorize the business customer as a "small business" (because $300,000 is less than the example $500,000 threshold) without having to obtain additional aggregate gross receipts information from the customer, and without any obligation to seek such information.
    - This alternative approach would be far less administratively burdensome for the covered provider because the covered provider could apply the "small business" definition based on information the covered provider already obtains as part of its normal business activities, while also accomplishing the general purposes of the proposed rules. Moreover, if the DFPI proposed the small business reporting requirements out of a concern that covered providers were treating small businesses differently than larger business customers, this alternative approach would more closely align with the DFPI's purpose – after all, a covered provider could only treat small businesses differently based on income data that the covered provider has actually obtained, which is the same measure used under this alternative approach.
- As an additional fallback, any final version of section 1062(b) should permit covered providers to report on transactions in addition to those technically required under the Proposed Rule. This would allow covered providers to elect to report on additional transactions when there is

ambiguity as to whether certain of its business customers qualify as "small businesses" and therefore would be technically subject to reporting requirements – further supporting regulatory reporting while also avoiding covered providers' unintentionally mis-categorizing customers despite their best efforts.

The proposed regulations should be consistent with the scope of the CCFPL, which excludes certain entities from its reach.

As stated above, Section 90002 of Financial Code, titled "Exemptions," sets for a list of entities to which the CCFPL "shall not apply." That list includes entities that are already subject to licensing requirements and the DFPI regulation, such as for example finance lender, broker, program administrator, or mortgage loan originator under Division 9 of the Financial Code. Section 90002(b)(2). The regulations should make clear that those exemptions still apply to avoid any potential confusion regarding the scope of the law.

When the CCFPL was enacted it exempted certain entities regardless of whether it is (i) a bank, saving association or other related institutions; or (ii) federally chartered or chartered by state. The proposed regulations fail to mention whether such exemptions are still applicable.

- The exemptions should be clarified to not only include banks, but also include non-bank subsidiaries as their activities mimic bank activities, they are simply another financial arm of the bank.
- Banks whether federally or state chartered, along with their subs and affiliates, are highly regulated entities with the same regulatory oversight and should be exempt.
- Banks and their subsidiaries and affiliated entities already comply with numerous laws and regulations; including, but not limited to, Dodd-Frank Act, Unfair, Deceptive and Abusive Acts & Practices.

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We appreciate you taking the time to consider these important issues. If you have any questions or wish to discuss any aspect of our comments, please contact me or ETA Senior Vice President, Scott Talbott at

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Respectfully Submitted,

Matt Tremblay
Senior Manager, State Government
Relations Electronic Transactions Association
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