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**COMMENTS ON DEPARTMENT OF FINANCIAL PROTECTION AND INNOVATION
(DFPI) DRAFT REGULATIONS GOVERNING COMMERCIAL FINANCIAL PRODUCTS
AND SERVICES – PRO 02-21**

Aug. 8, 2022

I served from 2014-2018 as deputy commissioner and as special advisor to the commissioner at the Department of Business Oversight, now the DPF. Submitted below are comments regarding the DFPI's draft rulemaking on commercial financial products and services.

The DFPI issued the draft rules June 24, pursuant to the California Consumer Financial Protection Law (CCFPL).

The regulations: (1) prohibit providers of commercial financing, or other financial products or services, from engaging in unfair, deceptive or abusive acts or practices (UDAAPs) in transactions with small businesses, family farms or nonprofits; (2) define UDAAPs in connection with such transactions; (3) require providers to file with the DFPI annual reports containing specified data related to the covered transactions.

UDAAP Definitions

In Section 1061, the draft rules define what constitutes an unfair act or practice, a deceptive act or practice, and an abusive act or practice. These definitions generally track the UDAAP provisions in the federal Dodd-Frank Act. They also reference California Business and Professions Code 17200, which prohibits unfair or fraudulent acts or practices, and false or deceptive advertising.

The proposed UDAAP definitions seem sound and workable. They avoid problems of overbreadth and vagueness present in earlier versions of the language.

Small Business Definition

The draft rules define small business as having “the same meaning as in” subdivision (c) of Section 1028.5 of the Code of Civil Procedure. That statute defines small business as one that is independently owned and operated, not dominant in its field of operation *and* does not exceed certain benchmarks based on annual gross receipts or other measurements.

Per CCP 1028.5, agriculture, general construction, special trade construction, retail trade, wholesale trade, services, and transportation and warehousing businesses cannot exceed annual gross receipts caps, which vary depending on the industry. Manufacturing businesses cannot exceed 250 employees. Health care facilities cannot exceed either 150 beds or \$1.5 million annual gross receipts. Electrical power generators or transmitters cannot exceed 4,500 megawatt hours annually.

The proposed regulatory definition, in subdivision (f) of Section 1061 of the draft rules, raises questions.

CCP 1028.5 was enacted to allow small businesses to collect their litigation costs from regulatory agencies when the business prevails in a civil action against the agency. Is the definition of small business used in that context appropriate when determining the circumstances under which businesses obtain UDAAP protections?

Why should a small business’s access to UDAAP protections depend on the industry it’s in? For example, in retail trade, the annual gross receipts cap under CCP 1028.5 is \$2 million. In general construction, the cap is \$9.5 million. Why should a mom-and-pop bookstore be ineligible for UDAAP protections when its annual gross receipts top \$2 million, while a bigger construction firm remains eligible until its receipts exceed \$9.5 million? And why should a manufacturing enterprise retain protections no matter how much it earns, as long as its workforce numbers 250 or less?

Neither the draft rule, nor the Initial Statement of Reasons, make clear why such discrepancies represent appropriate policy.

Further, under the federal small business regulatory regime, on which CCP 1028.5 is based, the Small Business Administration reviews receipts caps every five years. If the SBA finds inflation has “significantly” eroded a cap’s value, it proposes a rule to increase the limit. Does the DFPI plan to follow that course? The draft rule does not make that clear.

In some industries, the SBA determines the receipts caps based on the average annual total over a three-year period. Does the DFPI plan to adopt that approach? The draft rule does not make that clear.

Additionally, CCP 1028.5 apparently was last amended in 1983, almost 40 years ago. Whether the list sufficiently reflects today’s economy seems a legitimate question.

There is a cleaner way to define small business. It would be more equitable across industries. Additionally, it would keep the DFPI out of the business of evaluating market dominance and appropriate size levels.

Specifically, the definition should limit eligible businesses to those that (1) are independently owned and operated, and (2) obtain commercial financing, or other financial services, valued at \$500,000 or less. The second suggested criterion tracks language in subdivision (n) of Section 22800 of the Financial Code. That provision is part of a statutory scheme added to the Financial Code in 2018 that requires providers to disclose specified information to small businesses in commercial financing transactions (Financial Code Section 22800, et seq.).

Data Collection/Reporting

Section 1062 of the draft rules requires covered providers to file with the DFPI annual reports containing specified data on their activities in the prior calendar year.

The required data include: (1) total number and total dollar amount of each type of commercial financing, or other financial product or service; (2) for each type of commercial financing, or other financial product or service, total number of transactions broken down by seven ranges of dollar amounts financed; (3) for each type of commercial financing, or other financial product or service, and for each range of dollar amounts financed, the minimum, maximum, average and median total cost of financing, expressed as an annualized rate.

These reporting requirements are appropriate. Interestingly, however, the second and third categories of required data reference “amount financed.” It’s unclear how that term applies to “other financial product or service.”

A note about Section 1062’s requirement to report the “minimum, maximum, average and median total cost of financing expressed as an annualized rate”: The provision references recently-finalized regulations adopted by the DFPI pursuant to the above-referenced 2018 commercial financing disclosure law. That statute’s requirement to disclose total financing costs as an annualized rate expires at the end of 2023, unless extended by legislation. That factor, it seems, should be kept in mind as the regulatory process continues.

Three amendments would improve Section 1062.

First, language should be added to specify that providers’ annual reports “shall be made available to the public for inspection.” Second, a provision should be added that requires the DFPI to publish an annual composite report based on covered providers’ individual reports. Third, language should be added that grants the DFPI Commissioner discretion to augment the reporting requirements with “relevant information the Commissioner reasonably requires concerning the business and operations” of covered providers.

The first and third suggested amendments track language in Section 22159 of the Financial Code. The second tracks language in Section 22160 of the Financial Code.