

FINAL STATEMENT OF REASONS
FOR THE ADOPTION OF RULES UNDER THE
CALIFORNIA DEFERRED DEPOSIT TRANSACTION LAW

As required by Section 11346.2 of the Government Code, the California Corporations Commissioner ("Commissioner") sets forth below the reasons for the adoption of Sections 2025, 2026, 2027, 2028 and 2029 to Article 2 and Section 2030 to Article 3 of Subchapter 13 of Title 10 of the California Code of Regulations (10 C.C.R. §§2025 – 2029, 2030).

The California Legislature enacted Senate Bill 898 (Chapter 777, Statutes of 2002), which is known as the California Deferred Deposit Transaction Law ("CDDTL"). The CDDTL sets forth the regulatory provisions governing the business of deferred deposit transactions and transfers the corresponding responsibilities from the Department of Justice to the Department of Corporations ("Department"). The CDDTL became effective on January 1, 2003 and became operative on December 31, 2004.

The CDDTL requires that each licensee to keep and use books, accounts and records that will enable the Commissioner to determine whether the licensee is complying with the CDDTL during the Commissioner's examination not less than once every two years. (Financial Code §§23024, 23046.) Further, each licensee is required to maintain any other records as required by the Commissioner. (Financial Code §23024.) All records are required to be kept for two years from the date of the last entry on a deferred deposit transaction. (*Ibid.*) All licensees submitted an authorization for disclosure of financial records with the license application. Proposed Sections 2025, 2026, 2027, 2028 and 2029 contain the books and records requirements to comply with the provisions of the CDDTL.

The CDDTL also requires that all licensees file an annual report with the Commissioner. (Financial Code §23026.) The required criterion is enumerated in Financial Code Section 23026. The information filed by all of the licensees will be incorporated into a consolidated report and made available to the public. (*Ibid.*) Proposed Section 2030 contains the annual report requirements to comply with Section 23026 of the CDDTL.

In order to comply with the Administrative Procedure Act (Government Code §§ 11370, et seq.), the Department proposes to adopt Sections 2025, 2026, 2027, 2028 and 2029 to Article 2 of Subchapter 13 of Title 10 of the California Code of Regulations for the books and records requirements. Additionally, the Department proposes to add Section 2030 to Article 3 of the same title and chapter for the annual report requirements.

Section 2025

The CDDTL requires each licensee to keep and use books, accounts and records that will enable the Commissioner to determine if the licensee is complying with the CDDTL and any other records required by the Commissioner. (Financial Code §23024.) All records are required to be kept for two years from the date of the last entry on a deferred deposit transaction. (*Ibid.*) All licensees submitted an authorization for disclosure of financial records with the license

application. Further, the Commissioner may make a written demand to require the production of all books, records, and supporting data used by the licensee to in preparation of reports to the Commissioner. (Financial Code §23048(b).)

Section 2025 sets forth the books, records and accounts required to be maintained by the CDDTL licensee at the licensee's main office and at each licensed business location, and the requirements for maintaining and storing the records, with the option to do so electronically. The records identified are based on the requirements under Financial Code Sections 23007, 23013, 23035 and 23036 and the prohibitions under Financial Code Section 23037. The rule additionally requires licensees to maintain an advertising file as provided in Financial Code Section 23027.

The rule further provides licensees the option of maintaining some records off-site, provided that the records are made available to the Commissioner within 48 hours of a request. The records required by this rule are integral components of the deferred deposit transaction process and the maintenance of the transactions, and are necessary to determine if licensees are complying with the provisions of the CDDTL.

Section 2026

Section 2026 requires that the CDDTL licensee must maintain the books, accounts and records in accordance with generally accounting principles and practices to enable the Commissioner to determine compliance with the CDDTL. The financial records, which are part of the books, accounts and records, are required to be prepared in accordance with generally accepted accounting principles. (Financial Code §23007.) To the extent that books, records and accounts do not involve accounting, they are required to be maintained in accordance with good business practices. "Good business practices" are based on the statutory requirements set forth in Financial Code Section 23024. The format identified is necessary for the Commissioner to examine records maintained in a consistent manner and to determine compliance as mandated by the CDDTL. (Financial Code §23024.)

Section 2027

Section 2027 requires CDDTL licensees to maintain separate records for each business location, except as provided. Licensees are required to hold a license for each business location. (Financial Code §23020 [licensee shall maintain one place of business under license]; See Financial Code §23005 [application required for each business location], Financial Code §23023 [licensee not required to transact business under other name or place of business other than that named in license].) The record retention for each business location is necessary for the Commissioner to determine compliance pursuant to Financial Code Section 23024.

Section 2028

Section 2028 sets forth the records to be maintained by a CDDTL licensee when any deferred deposit transaction is sold, transferred or assigned within the same business outside or within California or to an affiliate. Licensees are allowed to sell or otherwise transfer the debt at a later date under Financial Code Section 23035, subdivision (i). Financial Code Section 23024 expressly provides that "[e]ach licensee shall maintain any other records as required by the

[C]ommissioner.” (Financial Code §23024.) The records specified in the rule are necessary for the Commissioner to determine compliance with the CDDTL. (Financial Code § 23024.)

Section 2029

Section 2029 sets forth the records to be maintained by a CDDTL licensee when any deferred deposit transaction is sold, transferred or assigned to an unaffiliated entity. Licensees are allowed to sell or otherwise transfer the debt at a later date under Financial Code Section 23035, subdivision (i). Financial Code Section 23024 expressly provides that “[e]ach licensee shall maintain any other records as required by the [C]ommissioner.” (Financial Code §23024.) The records specified in the proposed rule are necessary for the Commissioner to determine compliance with the CDDTL. (*Ibid.*)

Section 2030

Section 2030 contains the annual report form with instructions for CDDTL licensees to file on or before March 15th of each year, beginning March 2006. (Financial Code §23026.) The adoption of an annual report form is necessary to implement the reporting requirement. Financial Code Section 23026 states that the annual report will be filed with the Commissioner “pursuant to procedures that the [C]ommissioner shall establish.” (Financial Code §23026.) More specific reasons for the necessity of the provisions in the form are discussed below.

The information requested on the cover page of the annual report relates to general information about the licensee, including the licensee’s name, business contact information, office hours, number and identification of licenses held, and type of organization. This general information is necessary to provide a means by which the Department may obtain identifying information about the licensee filing the annual report. (As examples, see Financial Code §§ 23009 [name of Licensee, address, whether licensee is a corporation or partnership]; 23021 [change of place of business]; and 23023 [name of business].)

Items 1 and 2 of the activity report request information on the total number and dollar amount of deferred deposit transaction made by the licensee. This information is expressly required under Financial Code Section 23026, subdivision (a).

Item 3 of the activity report requests information on the total number of individual customers who obtained deferred deposit transactions from the licensee. This information is expressly required under Financial Code Section 23026, subdivision (b). Instructions are provided for calculating Item 3 so that each individual annual report is prepared in a consistent and reliable manner to enable the Commissioner to determine compliance with the statutory requirements.

Items 4, 5 and 6 of the activity report request information on the minimum, maximum and average amount of deferred deposit transactions made by the licensee. This information is expressly required under Financial Code Section 23026, subdivision (c). Instructions are provided for calculating Item 6 so that each individual annual report is prepared in a consistent and reliable manner to enable the Commissioner to determine compliance with the statutory requirements.

Item 7 of the activity report requests information on the average annual percentage rate of deferred deposit transactions agreed to by the licensee. This information is expressly required under Financial Code Section 23026, subdivision (d). Instructions are provided for calculating Item 7 so that each individual annual report is prepared in a consistent and reliable manner to enable the Commissioner to determine compliance with the statutory requirements.

Item 8 of the activity report requests information on the average number of days of deferred deposit transactions made by the licensee. This information is expressly required under Financial Code Section 23026, subdivision (e).

Items 9 and 10 of the activity report request information on the total number and dollar amount of returned checks received by the licensee. This information is expressly required under Financial Code Section 23026, subdivision (f).

Items 11 and 12 of the activity report request information on the total number and dollar amount of checks recovered by the licensee. This information is expressly required under Financial Code Section 23026, subdivision (g). Instructions are provided for calculating Items 11 and 12 to provide licensees with guidance on whether to count partial recoveries and to ensure that each report is prepared in a consistent and reliable manner.

Items 13 and 14 of the activity report request information on the total number and dollar amount of checks charged off by the licensee. This information is expressly required under Financial Code Section 23026, subdivision (h). Instructions are provided for calculating Items 13 and 14 to provide licensees with guidance on whether to count partial balances charged off and to ensure that each report is prepared in a consistent and reliable manner.

The verification Section requests the name and title of the person who is executing the form who is attesting to the veracity of the report to the best of the licensee's knowledge. If the business location is in California, the verification is executed under penalty of perjury. If the business location is outside of California, execution of the verification must be notarized. Existing law does not require this format but it is needed to ensure that licensees are complying with the CDDTL by filing accurate documents.

Instructions for the form have been included to clarify how the form is to be filled out by CDDTL licensee. Existing law does not require instructions to be included with the filing of the report. Instructions are included because they provide assistance to licensees and merely clarify the form.

DETERMINATIONS

The Commissioner has determined that the adoption of the regulation does not impose a mandate on local agencies or school districts, which require reimbursement pursuant to Part 7 (commencing with Section 17500) of Division 4 of the Government Code.

ALTERNATIVES CONSIDERED

The proposed rules implement and clarify the provisions set forth by Financial Code Sections 23024, 23026 and 23046 for books and records retention and the format of the annual report required of CDDTL licensees. No reasonable alternative considered by the Department

would be more effective in carrying out the purpose for which the regulation is proposed, or would be as effective and less burdensome to affected private persons, or would lessen any adverse impact on small businesses.

ADDENDUM, REGARDING PUBLIC COMMENTS

No request for hearing was received no later than 15 days prior to the close of the written comment period. (Government Code Section 11346.5(a)(17).) Accordingly, no hearing was scheduled or held. A hearing request was received later than 15 days prior to the close of the written comment period from the CDDTL industry group, the California Financial Service Providers. This group requested a hearing on a revised proposal, rather than the initial rulemaking action. The Department met with industry representatives and the CDDTL Advisory Group to present draft revisions and obtain comments prior to moving forward with a 15-day comment period for revisions to this rulemaking action.

COMMENTS RECEIVED DURING THE 45-DAY COMMENT PERIOD

COMMENTOR: Letter dated February 7, 2005, from R. Paul Soter, Jr. Counsel to the California Financial Service Providers ("CFSP").

COMMENT 1: CFSP believes that the proposed regulatory action will have a significant economic impact on businesses licensed under the CDDTL.

RESPONSE: The Department has amended the proposed rules to change the regulatory requirements that were identified as imposing a cost of licensees, such as the requirements for electronic record-keeping. For the final rules, the Department requested the CDDTL Advisory Group provide direction on where any costs would be incurred in compliance with the regulations. In light of the changes made to the rules, the Department is not aware any significant economic impact on businesses beyond those imposed by the statutory requirements of the CDDTL.

COMMENT 2: As proposed Section 2025(a) requires the storage of all books, records, and accounts must be maintained at a licensee's licensed location. Most licensees stored their inactive loan files and other records off-site. Also licensees with branch networks have computerized accounting systems maintained at the headquarters of the business. Section 2025(a) needs to address the storage issue of inactive loan files and other records, and computerized accounting by allowing for off-site storage of loan records beyond a specific time frame, with a requirement that the licensee make them available to the Department within 24-hours of a request by the Department.

RESPONSE: The proposed rule was amended to allow a licensed location to maintain records older than 90 days at a location other than the licensed location, provided that the records are made available to the Commissioner within 48 hours of a request.

Further, the proposed rule was amended to provide that financial records be maintained at either the licensed location or the mailing address provided in the long form application, which will presumably encompass the licensee's headquarters and allow for the centralized keeping of accounting and financial records. Records to be maintained at individual branch offices include the records of individual deferred deposit transactions, and as noted these records may be stored off-site after 90 days.

COMMENT 3: It is unclear as to the purpose of the Section 2025(b) requirement that the licensee maintain a copy of the customer's personal check. The administrative effort and expense this requirement would entail will be burdensome for the licensees.

RESPONSE: The proposed rule was amended to require evidence of the check, to ensure that the Department is able to use the information normally contained in a paper or electronic check to ensure compliance with the requirements of the law.

COMMENT 4: The Section 2025(b) requirement that a record of time periods for each transaction be maintained is a potentially significant burden on licensees, since some licensees pay off their advances before the due date. Not all licensees, especially the smaller licensees, currently keep track of this information. This requirement may be potentially burdensome on licensees due to the cost of new policies and procedures, training management and staff.

RESPONSE: The requirement is only that licensees keep a record of the length of the transaction for each advance, not the payoff date. To ensure that a personal check is not deferred for a period exceeding 31 days, it is necessary to require records of time periods for transactions. See Financial Code Section 23035(a) for the 31-day limitation. Moreover, recording of time period for each transaction will enable the Department to more efficiently carry out its reporting responsibilities, including recommendations for specifications regarding the length of time for deferred deposit transactions. See Financial Code Section 23057. From a transaction standpoint, this information is needed to calculate the APR disclosed to each customer. As a final note, CFSP may have misconstrued the record-keeping requirement since the Department is requesting each licensee to track the contractual time period in the written agreement, not the actual pay-off time period.

COMMENT 5: Section 2025(d) raises operational and technical issues, and appears to hold electronic records to a higher standard than paper records. (1) The proposal does not differentiate between active and inactive records, and between backups and archives of records. (2) The proposal requiring electronic records to be maintained on WORM media would be substantial and could result in significant expense for licensees and would place a higher burden of trustworthiness for electronic records than for paper records.

RESPONSE: The Department has amended Section 2025 to allow for the off-site maintenance of records older than 90 days, which encompasses electronic records that may be inactive records or archives of records. The Department has further amended subsection (d)(3) of Section 2025 to eliminate the WORM media requirement and instead require that electronic records be maintained in a media that ensures reliable, credible, accurate and auditable records. As amended, the standards do not appear to be any greater than the standards for paper records.

COMMENT 6: CFSP has specific comments to some of the items on the form in Section 2030(a). (1) It is suggested that the office hours on the form be deleted along with the requirement for a list of licensed locations. (2) The APR in Item 7 of the form is not captured by most licensees. Most licensees do capture the amount, term and finance charge for each deferred deposit transaction. (3) CFSP is concerned with the requirement in Item 8 of the form because it is not required by the CDDTL. (4) The Department needs to provide guidance to how a licensee is to respond to Item 11 and Item 13 of the form.

RESPONSE: The Department has amended Section 2030 to eliminate the request for office hours and the list of licensed locations. Instead, under Section 2025 licensees must maintain the list of licensed locations at the licensees' main office or headquarters, and the Department may review this list during on-site examinations. Thus, the Department will be able to ensure that all branch offices are appropriately licensed by the Department, and all branch office closings are recorded properly.

Item 7: With respect to the APR, Financial Code Section 23026 requires the annual report include the "average annual percentage rates of deferred deposits." The Department concludes that the annual percentage rate on the agreements of all transactions divided by the total number of transactions meets this requirement of the code.

Item 8: This item has been amended to request the average number of days of deferred deposit transactions, rather than the average days the transactions are outstanding, in order to address CFSP's concerns and to follow the statutory directive in Financial Code Section 23026.

Items 11 and 13: To address CFSP's concerns that no guidance is provided on how to handle partial recoveries and partial charge-offs, the Department has included direction in Items 11 through 14 of the report to include partial recoveries and partial charge-offs.

COMMENT 7: CFSP has specific comments on items in the instructions in Section 2030(b). (1) As written a licensee's license will be revoked for failure to file the annual report. The Department needs to clarify this statement. The CDDTL provides for a notice and hearing before a Summary Revocation of a licensee's license. (2) CFSP's concerns with Item 4 and Item 5 of the instruction are the same as its concerns in COMMENT 6 above.

RESPONSE: The proposed rule has been revised to provide that the failure to file the report may (rather than shall) result in the revocation of a licensee's license. With respect the additional comments on the instructions for the annual report, all instructions were revised to accommodate the revised questions (as identified in the response to Comment 6).

COMMENT 8: CFSP has requested the Department to schedule a public hearing on the proposed final text.

RESPONSE: Because the hearing was requested on the final text rather than the proposed text, and because the hearing request was not received before 15 days of the close of the comment period, a hearing is not required and is thereby decline. Moreover, a hearing is not necessary because the Department met with CFSP and the CDDTL Advisory Group in open meetings to discuss the concerns raised by CFSP and to discuss draft amendments to the rules that would resolve the industry's concerns. The amendments made to the proposed rules incorporate many of the industry's suggestions.

COMMENTOR: E-mailed letter dated February 7, 2005 from Carole Wilson from Advocation, Inc.

COMMENT: Comments on the proposed rulemaking file are the same as the above Comments 1 through 8.

RESPONSE: Response on the proposed rulemaking file are the same as the above Responses to Comments 1 through 8.

COMMENTOR: Facsimile dated February 17, 2005, from Koji Kawana representing K3 Alliance, Inc., Beach Financial, LLC, Atlantic Financial, LLC, CR Financial, LLC, RGR Financial, LLC, and ER Financial, LLC.

COMMENT 1: Our software doesn't allow us to pull total individual customers as required in Item 3 of the Annual Report. We will not be able to comply with this requirement.

RESPONSE: Financial Code Section 23026(b) requires that the report contain the total number of individual customers who entered into deferred deposit transactions, and therefore the Department doesn't have discretion to eliminate this requirement. Nevertheless, the Department will work with licensees to the extent practicable to accommodate reporting challenges during the initial implementation of the reporting requirement.

COMMENT 2: In order to comply with Items 7 and 8 of the Annual Report, we would need to do a manual calculation to pull the average APR of all transactions and the average number of days. This will be burdensome and a significant expense.

RESPONSE: Subdivisions (d) and (e) of Financial Code Section 23026 require, respectively, that the report include the average annual percentage rate of deferred deposits and the average number of days of deferred deposit transactions. Nevertheless, the Department will work with licensees to the extent practicable to accommodate reporting challenges during the initial implementation of the reporting requirement.

COMMENT 3: Our software will not be able to extract the information required for Items 9 and 10 of the Annual Report. We would have to review our bank statements to comply with this requirement and the accuracy will be questionable.

RESPONSE: Financial Code Section 23026(f) requires that the report include the total number and dollar amount of returned checks. Nevertheless, the Department will work with licensees to the extent practicable to accommodate reporting challenges during the initial implementation of the reporting requirement.

COMMENT 4: Requiring a licensee to report the total number of recovered checks in Item 11 of the Annual Report is an unattainable number, and we will not be able to comply with this requirement. This requirement is burdensome and will create a significant cost to licensees.

RESPONSE: Financial Code Section 23026(g) requires that the report include the total number and dollar amount of checks recovered. Nevertheless, the Department will work with licensees to the extent practicable to accommodate reporting challenges during the initial implementation of the reporting requirement.

COMMENTS RECEIVED DURING THE 15-DAY COMMENT PERIOD

COMMENTOR: Letter dated November 8, 2005, from Koji Kawana representing K3 Alliance, Inc., Beach Financial, LLC, Atlantic Financial, LLC, CR Financial, LLC, RGR Financial, LLC, and ER Financial, LLC.

COMMENT 1: The software we are using will not allow us to extract data to comply with the year-end report required by the California Deferred Deposit Transaction Law. Specifically question number 3 is asking for the total number of individual customers, counting repeat customers only once; question number 7 is asking the average Annual Percentage Rate; question number 8 is asking the average number of days; and question number 11 is asking the total number of returned checks recovered (including partial recoveries). Also, the Department of Corporations needs to clarify what is considered a partial recovery. The only way we can respond to questions 3, 7, 8 and 11 is to do it manually, which could take months to calculate.

RESPONSE: As indicated in the responses to the questions in the February 17, 2005 letter, the specific items requested in annual report is dictated by Financial Code Section 23026, and therefore the Department has no ability to exclude these items from the annual report. The decision to include partial recoveries and partial balances in determining number of returned checks and number of transactions charged off was to solve the initial question posed by the industry of how to handle such recoveries and charge-offs, when determining the total number. A partial recovery is where the licensee recovers less than the full amount of the returned check.

As noted previously, the Department will work with licensees to the extent practicable to accommodate reporting challenges during the initial implementation of the reporting requirement.

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