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Calif. Could Soon Create 'Mini-CFPB': 5 Things To Know

By **Jon Hill**

Law360 (September 8, 2020, 10:20 PM EDT) -- California's financial services regulator could soon get an upgrade after state lawmakers passed legislation that would revamp the agency in the image of the U.S. Consumer Financial Protection Bureau, signaling an increased focus on fintech in particular.

In a last-minute push last week before adjourning for the year, legislators in Sacramento sent the California Consumer Financial Protection Law to Gov. Gavin Newsom for his expected approval, moving the state one step closer to realizing plans he and other Democrats have championed to beef up its regulation of the financial services industry.

To that end, the CCFPL calls for transforming the state's current financial services watchdog, known as the Department of Business Oversight, into the Department of Financial Protection and Innovation, an agency whose additional resources and expanded authorities have drawn comparisons to a "mini-CFPB."

"The DBO had authority to enforce specific laws," said Nancy R. Thomas, a financial services litigation partner at Morrison & Foerster LLP. "Now, the focus is on the kinds of products and services that are being offered without having to tie the agency's authority to a particular statute, and that gives the new DFPI broader authority to reach products and services that the agency couldn't reach before now."

"This change is modeled on what the Dodd-Frank Act's Title X did for the CFPB," Thomas added. "Instead of an agency that has authority to enforce particular laws, it's an agency focused on consumer financial products and services."

But what could that mean for financial services companies operating in California? And could other states soon follow suit? Here are five key points to know about the DFPI, according to attorneys who spoke to Law360.

Fintechs in Focus

The legislation approved would fold the DBO's existing licensing and prudential regulatory functions over state-chartered banks, mortgage lenders and others into the DFPI, while also giving the new agency more authority to oversee companies that weren't previously within the DBO's purview, like debt collectors, consumer reporting agencies and certain fintech companies.

"There were products and services that weren't fully covered by existing laws," Thomas said, citing cryptocurrency as an example. "But now, the focus on registration, examination, and enforcement is

going to be more on the nature of the products and services. That's going to make a big difference in the new agency's authority."

Pratin Vallabhaneni, a partner in White & Case LLP's financial institutions advisory practice, said this recalibrated approach stands to be a particularly significant change for California's burgeoning fintech industry, which hasn't had consistent, unified consumer protection oversight at the state level before.

"A lot of the emerging fintech companies and other entities that don't have a broad prudential regulator are clearly the focus," Vallabhaneni said. "The real target entities for bringing UDAAP actions will probably be the nonbank fintechs and new emerging companies."

Expanded Enforcement Authority ...

UDAAP refers to unfair, deceptive or abusive acts or practices, types of misconduct that are policed at the federal level by the CFPB. Although the Dodd-Frank Act allows state attorneys general and banking regulators to exercise this authority, state statutes have authorized them only to go after conduct they deem unfair or deceptive.

Some states have explored adding an abusiveness prong to their UDAP laws to broaden the scope of their powers, and in keeping with this trend, California's new law would entrust CFPB-like authority to the DFPI to bring enforcement actions for and write rules defining abusive conduct, as well the unfair and deceptive varieties, in the consumer financial services space.

"In theory, it adds another prong in the UDAAP arsenal for the agency," Thomas said.

Given that there's still a significant legal debate around what counts as abusiveness, this expanded authority could be intimidating for financial services providers operating in a state that hasn't historically been shy about enforcement. But as Thomas pointed out, abusiveness claims have been rare at the federal level and are generally seen as having a lot of overlap with the other UDAAP prongs.

"It remains to be seen how much additional authority is created by adding abusive to the DFPI's UDAAP authority," Thomas said.

Hinshaw & Culbertson LLP partner Vaishali Rao, who heads the regulatory and compliance team of the firm's consumer financial services practice, was skeptical that this aspect of the DFPI's design would significantly change how the companies under its umbrella think about compliance.

"When companies are deciding what to do and what not to do, they're usually taking the conservative approach," Rao said. "If it's going to be considered unfair or deceptive, it's probably going to also be considered abusive, and they're not going to do it."

... With Some Caveats

At the same time, the CCFPL broadly exempts national and state-chartered banks, credit unions and current California licensees from its consumer compliance oversight and enforcement framework, echoing the way Dodd-Frank limits the CFPB's power over banks with under $10 billion in assets.

This carveout was a late addition to the law and was intended to allay concerns about overburdening already-regulated companies, according to Thomas.

"As the DBO was talking to stakeholders about this new law, they kept telling regulated entities that there wasn't going to be a change for them," Thomas said. "They're still regulated by the banking agency, and the banking agency has always had regulatory, supervision, and enforcement authority over licensees."

The arrangement also sets up the DFPI to have a sharper consumer protection focus on financial products and services offered by nonbanks and other less-regulated players in the industry.

"When you have a generalist regulator like a state attorney general, they can only put so much of their attention on financial services," Vallabhaneni said. "By having a targeted agency with a very targeted approach to targeted harms ... the upshot will probably be not just a greater set of enforcement actions, but also a lot more research and industrywide sweeps."

A Road Map for Other States

The CCFPL's passage comes as a number of states have sought to strengthen their consumer financial protection capabilities during the Trump administration, which Democrats and consumer advocates have accused of steering the CFPB toward lax enforcement and dangerous deregulation.

Pennsylvania, New Jersey and New York have all formed versions of "mini-CFPBs" within existing state agencies in recent years, and before the COVID-19 crisis scrambled his policy agenda, New York Gov. Andrew Cuomo was working on plans to institute licensing requirements for debt collectors and equip his financial services regulator with abusiveness enforcement authority, among other things.

But the launch of the DFPI would eclipse these other efforts in size and scope, creating an agency that merges expanded statutory authority with increased funding and additional dedicated resources to exercise it, like the power to hire in-house counsel to prosecute enforcement actions and defend the agency in court.

While it may be no surprise that California, one of the country's wealthiest and most quintessentially blue states, would have the financial wherewithal and political will to soup up its financial services regulator in this way, Thomas said the DFPI could set a standard for other states to emulate.

"What we've seen in the last couple years is states creating a specific office or unit within the attorney general's office," Thomas said. "I'm not aware, though, of any similar legislation that expands the authority of the banking regulator along with the additional resources that create the teeth, so it does seem like we could see other states looking to this law as a model for how they might also implement or expand on their goal of creating a mini-CFPB."

Rao agreed that other states may take inspiration from California in seeking to strengthen their financial services regulation over the coming years, but she said the form those initiatives take could be shaped by the outcome of the upcoming presidential election.

If Joe Biden wins, for example, it's widely expected that he would clean house at the CFPB, installing a director with a much tougher approach to overseeing the financial services industry than the agency's current Trump-appointed leader. Such a move could diminish the perception of a federal regulatory vacuum that some states might otherwise feel compelled to fill, according to Rao.

"States are facing a lot of crises right now, and as much as they may feel like this is a priority, I don't think many are going to have funding to [replicate the DFPI model]," Rao said, adding that states may instead choose to lean more on the CFPB as a partner for coordinated enforcement and oversight.

Tight budgets will still be a constraint even if President Donald Trump wins re-election, Rao said, but less-flush states may at that point have more appetite for expending extra resources to prioritize consumer financial protection. Or they could, at a minimum, reallocate existing resources inside their attorney general offices, like the one in Illinois where Rao once worked on consumer fraud cases.

"There is flexibility within the states even right now to ramp up," Rao said. "If Trump wins, I see more things like this mini-CFPB in California happening. I don't think it'll happen everywhere, but I think it'll happen in probably more places, and I see more enforcement happening on AG side."

Some Things Take Time

Even if all goes according to plan, financial services attorneys told Law360 it could be some time before the new DFPI gets fully up to speed with all the restructuring and rulemaking required under the CCFPL, which itself wouldn't take effect until the beginning of next year.

"The California banking agency is a very big ship," Thomas said. "Turning it and expanding it significantly is not something that's going to happen on a dime. The agency has proposed a three-year, phased implementation, so regulated entities shouldn't expect a drastic change tomorrow or anytime soon. It will be much more gradual than that."

But Vallabhaneni cautioned that the DFPI could still move relatively quickly to begin enforcing the new law's UDAAP provisions.

"There's certainly no reason that the agency couldn't bring enforcement actions under the broad statutory provisions and not need any particular regulation," Vallabhaneni said. "That can happen quite fast, and that is in fact what happened at the federal level with the CFPB."

And California does have a reputation for aggressive enforcement. Rather than engage in rulemaking to promulgate industry standards, for example, the DBO often turned to enforcement as a tool to communicate its view of what was and wasn't acceptable behavior for the industry, according to Thomas.

The DFPI, by contrast, will have additional rulemaking resources and requirements than its predecessor, potentially curbing this impulse for "regulation by enforcement," Thomas said.

"But it remains to be seen whether they will be providing regulatory guideposts for regulated entities or continuing to rely primarily on enforcement," she said.

The timing of the CCFPL's passage also provides important context for where the new agency's initial enforcement focus might be, according to Rao. Coming amid a devastating pandemic that has wreaked economic havoc on countless Californians, the law underscores how much the state's policymakers want to see financial institutions doing right by struggling consumers, Rao said.

"This is a great time to test, test, test your systems so that you know, for example, if you are having disparate outcomes on repayment plans that you're offering to your consumers," Rao said of the state's

financial services providers. "Because when [the DFPI] does get formed, and when there is attention on particular companies' choices and practices, that's what you'll need to be able to say you've done right."

"A lot of fintech companies may not be used to that kind of rigor, which banks and other kinds of lenders or servicers have had to go through," Rao added. "Folks are going to have to invest more in compliance now for sure."

--Editing by Breda Lund and Brian Baresch.
