

The Banking Law Journal

Established 1889

An A.S. Pratt® PUBLICATION

JULY/AUGUST 2016

EDITOR'S NOTE: THE SUMMER READING ISSUE

Victoria Prussen Spears

POSSIBLE CHANGES TO THE FEDERAL TRADE COMMISSION'S "HOLDER RULE" COULD AFFECT CONSUMER FINANCE

Stephen J. Newman and Geoffrey L. Warner

IDENTIFYING SYSTEMIC RISK — A RISKY BUSINESS?

Edite Ligere

IMPLEMENTING "FUNGIBLE" INCREMENTAL TERM LOANS

Lauren Hanrahan, Andrew R. Walker, Eschi Rahimi-Laridjani,
Meir S. Hornung, and Charles Stern

SPLIT NINTH CIRCUIT NARROWS DEFINITION OF BAD FAITH INSIDER IN CRAMDOWN CASE

Michael L. Cook

BANKS FORFEIT PLEDGED COLLATERAL DUE TO THEIR FAILURE TO INVESTIGATE WARNING SIGNS OF BORROWER'S MISCONDUCT

Alan J. Lipkin

NARROWING OF LICENSING EXEMPTION UNDER CALIFORNIA FINANCE LENDERS LAW FOR CONSUMER LENDERS AND BROKERS

Henry M. Fields, Joseph Gabai, and Dina Kushner

REGIONAL BANKING OUTLOOK

James F. Bauerle

QUESTIONS ABOUT THIS PUBLICATION?

For questions about the **Editorial Content** appearing in these volumes or reprint permission, please call:

Matthew T. Burke at (800) 252-9257

Email: matthew.t.burke@lexisnexis.com

For assistance with replacement pages, shipments, billing or other customer service matters, please call:

Customer Services Department at (800) 833-9844

Outside the United States and Canada, please call (518) 487-3000

Fax Number (518) 487-3584

Customer Service Web site <http://www.lexisnexis.com/custserv/>

For information on other Matthew Bender publications, please call

Your account manager or (800) 223-1940

Outside the United States and Canada, please call (518) 487-3000

ISBN: 978-0-7698-7878-2 (print)

ISBN: 978-0-7698-8020-4 (eBook)

ISSN: 0005-5506 (Print)

ISSN: 2381-3512 (Online)

Cite this publication as:

The Banking Law Journal (LexisNexis A.S. Pratt)

Because the section you are citing may be revised in a later release, you may wish to photocopy or print out the section for convenient future reference.

This publication is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional services. If legal advice or other expert assistance is required, the services of a competent professional should be sought.

LexisNexis and the Knowledge Burst logo are registered trademarks of Reed Elsevier Properties Inc., used under license. Sheshunoff is a registered trademark of Reed Elsevier Properties SA, used under license.

Copyright © 2016 Reed Elsevier Properties SA, used under license by Matthew Bender & Company, Inc. All Rights Reserved.

No copyright is claimed by LexisNexis, Matthew Bender & Company, Inc., or Reed Elsevier Properties SA, in the text of statutes, regulations, and excerpts from court opinions quoted within this work. Permission to copy material may be licensed for a fee from the Copyright Clearance Center, 222 Rosewood Drive, Danvers, Mass. 01923, telephone (978) 750-8400.

An A.S. Pratt® Publication

Editorial Office
230 Park Ave., 7th Floor, New York, NY 10169 (800) 543-6862
www.lexisnexis.com

MATTHEW  BENDER

Editor-in-Chief, Editor & Board of Editors

EDITOR-IN-CHIEF

Steven A. Meyerowitz

President, Meyerowitz Communications Inc.

EDITOR

Victoria Prussen Spears

Senior Vice President, Meyerowitz Communications Inc.

Barkley Clark
*Partner, Stinson Leonard Street
LLP*

John F. Dolan
*Professor of Law
Wayne State Univ. Law School*

David F. Freeman, Jr.
Partner, Arnold & Porter LLP

Satish M. Kini
*Partner, Debevoise & Plimpton
LLP*

Douglas Landy
*Partner, Milbank, Tweed,
Hadley & McCloy LLP*

Paul L. Lee
*Of Counsel, Debevoise &
Plimpton LLP*

Jonathan R. Macey
*Professor of Law
Yale Law School*

Stephen J. Newman
*Partner, Stroock & Stroock &
Lavan LLP*

Bimal Patel
Partner, O'Melveny & Myers LLP

David Richardson
Partner, Dorsey & Whitney

Heath P. Tarbert
Partner, Allen & Overy LLP

Stephen B. Weissman
Partner, Rivkin Radler LLP

Elizabeth C. Yen
Partner, Hudson Cook, LLP

Regional Banking Outlook
James F. Bauerle
*Keevican Weiss Bauerle & Hirsch
LLC*

Intellectual Property
Stephen T. Schreiner
Partner, Goodwin Procter LLP

THE BANKING LAW JOURNAL (ISBN 978-0-76987-878-2) (USPS 003-160) is published ten times a year by Matthew Bender & Company, Inc. Periodicals Postage Paid at Washington, D.C., and at additional mailing offices. Copyright 2016 Reed Elsevier Properties SA., used under license by Matthew Bender & Company, Inc. No part of this journal may be reproduced in any form—by microfilm, xerography, or otherwise—or incorporated into any information retrieval system without the written permission of the copyright owner. For customer support, please contact LexisNexis Matthew Bender, 1275 Broadway, Albany, NY 12204 or e-mail Customer.Support@lexisnexis.com. Direct any editorial inquires and send any material for publication to Steven A. Meyerowitz, Editor-in-Chief, Meyerowitz Communications Inc., 26910 Grand Central Parkway, #18R, Floral Park, NY 11005, smeyerowitz@meyerowitzcommunications.com, 718.224.2258 (phone). Material for publication is welcomed—articles, decisions, or other items of interest to bankers, officers of financial institutions, and their attorneys. This publication is designed to be accurate and authoritative, but neither the publisher nor the authors are rendering legal, accounting, or other professional services in this publication. If legal or other expert advice is desired, retain the services of an appropriate professional. The articles and columns reflect only the present considerations and views of the authors and do not necessarily reflect those of the firms or organizations with which they are affiliated, any of the former or present clients of the

authors or their firms or organizations, or the editors or publisher.

POSTMASTER: Send address changes to THE BANKING LAW JOURNAL LexisNexis Matthew Bender, 230 Park Ave, 7th Floor, New York, NY 10169.

POSTMASTER: Send address changes to THE BANKING LAW JOURNAL, A.S. Pratt & Sons, 805 Fifteenth Street, NW., Third Floor, Washington, DC 20005-2207.

Narrowing of Licensing Exemption Under California Finance Lenders Law for Consumer Lenders and Brokers

*Henry M. Fields, Joseph Gabai, and Dina Kushner**

The California Department of Business Oversight has issued a new regulation that will eliminate a statutory licensing exemption under the California Finance Lenders Law for nonbank operating subsidiaries and affiliates of banks that are engaged in lending and/or brokering consumer loans. The authors of this article explain the regulation and its potential impact.

The California Department of Business Oversight (the “CDBO”) has issued a new regulation that will eliminate a statutory licensing exemption under the California Finance Lenders Law (the “CFLL”) for nonbank operating subsidiaries and affiliates of banks (among other entities) that are engaged in lending and/or brokering *consumer* loans. The regulation will take effect on September 28, 2016.

Operating subsidiaries and affiliates engaged in lending and/or brokering *commercial* loans only will not be affected by this regulation, despite initial proposals by the CDBO to the contrary.

BACKGROUND

Section 22050(a) of the California Financial Code provides an exemption for licensing under the CFLL for:

any person doing business under any law of any state or of the United States relating to banks, trust companies, saving and loan associations, insurance premium financing agencies, credit unions, small business investment companies, community advantage lenders, California business and industrial development corporations when acting under federal law or other state authority, or licensed pawnbrokers when acting under the authority of that license.

* Henry M. Fields is senior counsel at Morrison & Foerster LLP providing regulatory advice to international and domestic financial institutions. Joseph Gabai is senior counsel at the firm focusing on the representation of banks, savings associations, mortgage banking companies, finance companies, and their holding companies and affiliates. Dina Kushner is an associate in the Financial Transactions Group, and also is active within the firm’s Business Restructuring & Insolvency Group. The authors may be reached at hfields@mof.com, jgabai@mof.com, and dkushner@mof.com, respectively.

Under long-standing interpretations, this exemption has been construed to apply not only to banks but also to subsidiaries of banks. These interpretations were based on the rationale that such entities, albeit not banks themselves, were doing business under federal and state laws “relating to banks” (including federal and state laws regulating the activities of bank subsidiaries). In addition, based on this rationale, bank holding companies and their nonbank subsidiaries (and foreign banks regulated as bank holding companies under the International Banking Act of 1978) have been regarded as doing business under federal law—the Bank Holding Company Act—“relating to banks.”

The initial version of Section 1422.3 (the “Regulation”) of Title 10 of the California Code of Regulations would have eliminated the license exemption for any “nondepository operating subsidiary, affiliate, or agent” of a national bank (or of a federal savings association). A later version of the Regulation would have eliminated the license exemption for any nonbank operating subsidiaries, affiliates, and agents of state banks (among other entities). The principal intent of the proposed Regulation, based on the background provided by the CDBO,¹ was to permit the CDBO, under the CFLL, to regulate bank subsidiaries that engaged in consumer lending. The text of multiple versions of the proposed Regulation, however, had a significantly broader reach.

PUBLIC COMMENTS

During the public comment periods relating to certain versions of the Regulation, certain commentators objected to the proposed Regulation on the grounds, among others, that the proposed Regulation provided an overly constrictive interpretation of the statute and was not necessary. Others argued that, at a minimum, the proposed Regulation should not affect any lenders and/or brokers affiliated with banks, if such lenders or brokers are engaged solely in lending or brokering commercial,² rather than consumer,³ loans.

¹ Notice of Rulemaking Action and Initial Statement of Reasons (PRO 03/13).

² A “commercial loan” is a loan with a bona fide principal amount of \$5,000 or more, or any loan under an open-end credit program, the proceeds of which are intended by the borrower for use primarily for other than personal, family, or household purposes. The definition applies regardless of whether the loan is secured or unsecured, and regardless of the nature of any security for the loan. The lender is permitted to rely on any written statement of intended purposes signed by the borrower. *See* Cal. Fin. Code § 22502.

³ A “consumer loan” includes any loan of less than \$5,000 and any other loan “the proceeds of which are intended by the borrower for use primarily for personal, family or household purposes.” The lender is permitted to rely on any written statement of intended purposes signed by the borrower. *See* Cal. Fin. Code §§ 22203 and 22204.

IMPACT OF THE REGULATION

The CDBO's final version of the Regulation incorporates these comments and reads as set forth in Exhibit A. In sum, it withdraws the exemption for entities doing business under federal or state law relating to banks that engage in lending and/or brokering consumer loans.

The Regulation will become operative on September 28, 2016, at which time any consumer lenders and/or brokers that are covered by the Regulation must be licensed under the CFLL. As the licensing process can be a lengthy one, lenders and/or brokers that will be covered by the Regulation should consider commencing the licensing process promptly.

Bank subsidiaries and affiliates should review their lending operations carefully to determine whether the Regulation will require them to obtain a CFLL license. For example, a bank subsidiary or affiliate that is principally engaged in commercial lending, but which occasionally offers consumer loans to select customers on an accommodation basis, will not be able to provide those consumer loans without obtaining a CFLL license because the Regulation applies if a company makes even one consumer loan. Or, given the fact that the CFLL defines a "consumer loan" to include commercial purpose loans of less than \$5,000, a bank subsidiary or affiliate that offers small commercial purpose loans of this magnitude will require a CFLL license as a result of the Regulation. In addition, even where a bank subsidiary or affiliate remains outside of the licensing requirements of the CFLL, it should consider other licensing and regulatory issues as applicable (*e.g.*, licensing issues under the California Real Estate Law, usury, adherence to safety and soundness standards, compliance with Bank Secrecy Act and anti-money laundering laws, etc.).

EXHIBIT A

Final Text of Section 1422.3

§ 1422.3. Certain Consumer Lenders and Brokers Not Exempt from Licensure.

- (a) A nondepository lender or broker that engages in the business of making or brokering consumer loans in this state is not exempt from licensure under subdivision (a) of section 22050 of the Financial Code unless that nondepository lender or broker is a bank, trust company, savings and loan association, insurance premium finance agency, credit union, small business investment company, community advantage lender, California business and industrial development corporation when acting under federal law or other state authority, or

a licensed pawnbroker when acting under the authority of that license.

- (b) For purposes of this section, nondepository “lender or broker” means a finance lender as defined in section 22009 of the Financial Code or a broker as defined in section 22004 of the Financial Code, and the finance lender or broker is also (1) a bank holding company or subsidiary of a bank holding company, as defined in chapter 17 of title 12 of the United States Code (commencing with section 1841), (2) a savings and loan holding company or a subsidiary of a savings and loan holding company, as defined in section 10 of the Home Owners’ Loan Act (12 U.S.C. § 1467a), or (3) a subsidiary of a bank, trust company, savings association or credit union, where the terms “bank,” “trust company,” “savings association” and “credit union” have the definitions ascribed to such terms in chapter 1 of division 1 of the Financial Code, and the term “subsidiary” means a subsidiary as defined in title 10, section 10.170 of the California Code of Regulations. For avoidance of doubt, the term “bank” includes a national bank, as such term is defined in section 189 of the Financial Code, and the term “savings association” includes a federal savings association or federal savings bank that is chartered under section 5 of the Home Owners’ Loan Act (12 U.S.C. § 1464).
- (c) This section shall become operative 180 days after the effective date of this section.

Note: Authority cited: Section 22150, Financial Code. Reference: Sections 22004, 22009, 22050, and 22100, Financial Code.