LOS ANGELES & SAN FRANCISCO
Daily Journal
www.dailyjournal.com
TUESDAY, SEPTEMBER 15, 2020

PERSPECTIVE

CFPB, California style: New agency will transform banking regulation

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California has become the latest state to create its own mini-Consumer Financial Protection Bureau. In a one-two punch, we will see an expanded and reorganized banking regulator and a new law giving the agency new unfair, deceptive and abusive, referred to as UDAAP, and other authority mirroring the CFPB's authority under the Dodd-Frank Act Title X.

This reorganization and expansion of the state banking agency is the latest in California's attempts to lead the way in state consumer protection. Governor Gavin Newsom specifically called out the Trump administration in identifying the need for these changes, and he and others consulted with former CFPB Director Richard Cordray on the legislation.

Here are the key changes coming for banks and non-banks that provide financial products and services to California consumers and small businesses:

A New Name and Much Bigger Budget

The current California banking regulator, the Department of Business Oversight, will transform into the Department of Financial Protection and Innovation. The budget provides $10.2 million in 2020–21, growing to $19.3 million in three years, to fund the DFPI reorganization and expansion as well as the initial implementation of the new law, the California Consumer Financial Protection Law. The DFPI will add 90 new employees to supervise, draft regulations, and enforce the CCFPL and existing law.

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Focus on Expanded Consumer Protection

The goal of the agency reorganization is to create "a singular body to oversee the state's providers of financial products and services" to protect "consumers vulnerable to abusive financial services and products." A new Consumer Financial Protection Division will focus on vulnerable consumers. The DFPI will have an expanded Supervision and Registration Office to handle the expected registration of 9,000 companies. An expanded Enforcement Division will have "significant resources for complex investigations and prosecutions."

New Authority over Previously Unregulated Companies

The broad jurisdiction in the newly passed CCFPL applies almost exclusively to entities that previously were not subject to the DBO's jurisdiction. These entities must be "covered persons," which are persons engaging in offering or providing consumer financial products or services, as well as certain affiliates and service providers. Cal. Fin. Code Section 90005(f). Covered persons will include student loan servicers, payday lender, debt collectors, consumer reporting agencies, and certain fintech companies. In a legislative compromise, national and state-chartered banks, most existing DBO licensees, and licensees of other California agencies acting under authority of the other agency's license are exempted from most of the CCFPL's provisions. Cal. Fin. Code Section 90002.

Covered persons will be subject to registration, supervision and investigation by the DFPI. The law gives the DFPI broad authority to enforce the CCFPL and other consumer financial laws with respect to covered persons, including filing claims in court and imposing very large penalties. Cal. Fin. Code Sections 90003, 90012, 90015. Note that the original version of the CCFPL would have given the DFPI jurisdiction to enforce a list of over 50 state and 20 federal "enumerated consumer financial laws." This lengthy list and the express grant of jurisdiction were deleted by amendment and are not included in the final version.

UDAAP Authority

The CCFPL gives the DFPI the same UDAAP authority that federal law gives the CFPB: The DFPI can pursue enforcement actions and issue regulations defining UDAAP as to covered persons. Cal. Fin. Code Section 90009(c), 90012(a); 12 U.S.C. Section 5531(a), (b).The DFPI also can bring proceedings to enforce Title X. Sec. 4 of the CCFPL, amending Cal. Fin. Code Section 326(b). The DFPI can bring these proceedings against both covered persons under the CCFPL and existing DBO licensees. The DFPI must give advance notice to the CFPB if it relies on this authority to bring actions against existing licensees.

The DFPI must interpret "unfair" and "deceptive" in accordance with Business and Professions Code Section 17200 and cases interpreting that provision. The CCFPL defines "abusive" in the same way that it is defined under Dodd-Frank and requires the DFPI to interpret the term consistently with Title X. Any inconsistency, though, is to be resolved in favor of greater protections and more expansive coverage. Cal. Fin. Code Section 90005(p).

New Focus on Innovation

The DFPI will create a new Financial Technology Innovation Office. Cal. Fin. Code Section 90006(d). This new Office will focus on encouraging innovation and job creation and researching new industries and technologies. The focus on innovation could provide guidance for fintechs and bank/fintech partnerships.

Further Blurring of Consumer and Small Business Lending Regulation

In the only provision in the law that does not concern consumers, the CCFPL authorizes the DFPI to define UDAAP in connection with the offering of commercial financing or other financial products and services to small businesses. Cal. Fin. Code Section 90009(e). These provisions follow the passage of the first-of-its-kind commercial financing disclosure law. Thus, the legislature continues to expand consumer protections to certain providers of smaller commercial loans.

Transparency and Legislative Limits on Authority

The DFPI will have to report annually on its progress in implementing the reorganization and the CCFPL, including the activities of the Financial Technology Innovation Office. This update will include an annual appearance before the legislature. Cal. Fin. Code Section 90009.5(d), 90018.

The CCFPL also includes several provisions that seem aimed at curbing the DBO's preference for regulating by enforcement and questions raised by the Legislative Analyst Office regarding the broad delegation of registration authority. The DFPI must issue regulations before it can bring enforcement proceedings regarding compliance with the complaint response procedures, registration requirements, recordkeeping requirements, and disclosures of the features of consumer financial products and services. Cal. Fin. Code Sections 90008(e); 90009(d). The Legislature must ratify the DFPI's registration regulations. Cal. Fin. Code Section 90009.5.

Time to Get Ready

Governor Newsom has until Sept. 30 to sign the CCFPL into law. If he does, it will become effective on Jan. 1, 2021. Thereafter, the DBO envisions a three-year, three-phase implementation of the CCFPL in which it begins registering new covered persons in year three.

In the meantime, financial services providers should watch New York and other states poised to follow in California's legislative footsteps. ■

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