

DEPARTMENT OF BUSINESS OVERSIGHT*Ensuring a Fair and Secure Financial Services Marketplace for all Californians*

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Commissioner of Business Oversight

March 6, 2014

**INVITATION FOR COMMENTS ON PROPOSED RULEMAKING UNDER
 THE CALIFORNIA FINANCE LENDERS LAW AND
 THE CALIFORNIA RESIDENTIAL MORTGAGE LENDING ACT
 PRO 03/13**

The Department of Business Oversight (“Department”) licenses and regulates finance lenders, brokers, mortgage lenders, and servicers under the California Finance Lenders Law (Financial Code Section 22000 et seq., the “CFL”) and the California Residential Mortgage Lending Act (Financial Code Section 50000 et seq., the “CRMLA”). Under the CFL and the CRMLA, it is unlawful for a finance lender, broker, mortgage lender, or servicer to conduct business without first being licensed by the Department, unless exempt from licensure requirements.

The Department is considering changes to the lending laws to clarify that non-depository operating subsidiaries, affiliates, and agents of federal banks and other financial institutions do not fall within the licensure exemption for a bank or savings association under the CFL and the CRMLA.¹ In accordance with Government Code Section 11346.45, the Department is seeking comments from interested parties and those who would be subject to the proposed regulations, prior to the Department providing notice of a proposed rulemaking action.

The Department is seeking comments on proposed new Sections 1422.3 and 1950.122.4.2, of Title 10 of the California Code of Regulations.

BACKGROUND

A. The Dodd-Frank Act

Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203, the Dodd-Frank Act or Dodd-Frank) on July 21, 2010 in a large part to address widely perceived causes of the financial crisis that befell the United States between 2007 to 2009—namely the downturn in the housing and financial markets and

¹ Subdivision (a) of Financial Code Section 22050, and paragraphs (1) and (2) of subdivision (c) of Financial Code Section 50002.

perceived abuses in the mortgage lending practices of national banks and nonbank mortgage lenders.²

The Dodd-Frank Act included language to scale back federal preemption as it impacts a state's enforcement of its consumer protection laws, and further expressly provided that states were not preempted from regulating state-chartered operating subsidiaries of national banks. In particular, the Dodd-Frank Act defined a "state consumer financial law" as a state law that does not discriminate against national banks and that directly and specifically regulates that manner, content, or terms and conditions of any financial transaction, or a related account, of a consumer. The Dodd-Frank Act provided that such a law is not preempted unless:

- The law would have a discriminatory effect on national banks, in comparison with the effect of the law on a state-chartered bank;
- The law prevents or significantly interferes with the exercise by the national bank of its powers; or
- Another federal law preempts the state law.

Notwithstanding the foregoing, the Dodd-Frank Act further contained a savings clause expressly providing that it does not preempt, annul, or affect the applicability of any state law to any subsidiary or affiliate of a national bank (provided that subsidiary or affiliate is not also a national bank). Consequently, the Dodd-Frank Act expressly made inapplicable many years of actions by federal agencies to preempt state oversight of subsidiaries and affiliates of national banks. The Department's proposed language would amend the regulations implementing the California Finance Lenders Law and the California Residential Mortgage Lending Act to clarify that the exemptions for banks and savings associations within these laws do not extend to operating subsidiaries and affiliates of these institutions, consistent with the Dodd-Frank Act.

Although the Dodd-Frank Act reframed the boundaries of what constitutes preemption with regard to a state's authority to regulate and enforce its consumer financial protection laws against national banks and federally-chartered savings associations, the Department's proposed language does not effectuate that part of Dodd-Frank.

The Department's proposal would implement only that part of the Dodd-Frank Act which eliminated federal preemption by the Office of the Comptroller of the Currency ("OCC") over state-incorporated non-bank operating subsidiaries, affiliates, and agents of banks and savings associations. To wit, the 2010 Senate Committee Report on the Dodd-Frank Act dated April 30, 2010, specifically stated:

Section 1045 clarifies that State law applies to State-chartered nondepository institution subsidiaries, affiliates, and agents of national

² "The Dodd-Frank Act's Expansion of State Authority to Protect Consumers of Financial Services," Arthur E. Wilmarth, Jr. (36 *Iowa J. Corp. L.* 893, 896, Summer, 2011).

banks, other than entities that are themselves chartered as national banks. Such entities are generally chartered by the States and therefore, should be subject to State Law.³

B. The Department's Past Commissioner's Interpretive Opinions⁴

In the 1990s, the Department had issued several past Commissioner's interpretive opinions which effectively provided an exemption from statutory licensure requirements under the CFLL and the CRMLA. These interpretive opinions provide exemptions to: operating subsidiaries of national banks,⁵ a wholly-owned subsidiary of a federal savings bank,⁶ operating subsidiaries of a federally chartered savings association,⁷ and an operating subsidiary of a bank holding company.⁸

The opinions generally concluded that the statutory exemption for "any person doing business under any law of any state or the United States relating to banks [and] savings and loan associations" was broad enough to encompass subsidiaries subject to limited federal oversight. These opinions generally concluded that the subsidiaries were exempt from licensure under the assumption that the cumulative effect of federal prudential regulatory efforts (i.e. by the OCC, the former Office of Thrift Supervision ("OTS"), the Federal Reserve Board, and the Federal Deposit Insurance Corporation) over nonbank operating subsidiaries were adequate to oversee and regulate entities which otherwise would have been required to be licensed by the Department.

While none of the interpretive opinions were based on claims of preemption by the federally-regulated entity,⁹ the opinions were based on a presumption of federal

³ *S. Rep. No. 111-176*, at 126 (2010).

⁴ The Commissioner of Business Oversight, formerly the Commissioner of Corporations, is authorized under both the California Finance Lenders Law (Financial Code Section 22150) and the California Residential Mortgage Lending Act (Financial Code Section 50312) to issue interpretive opinions (specific rulings). Interpretive opinions are legal opinions issued by the Commissioner on the breadth and interpretation of various laws administered by the Department. Distinguishable from a regulation, an interpretive opinion is not a rule of general application because it only applies to the particular entity and set of facts surrounding the opinion. Nevertheless, such opinions set forth the Commissioner's view on the applicability of the law to particular facts.

⁵ See Commissioner's Opinion, File No. OP 6590 CFLL, 1996 Cal. Sec. LEXIS 6, October 22, 1996.

⁶ See Commissioner's Opinion 95/1 RMLA, 1995 Cal. Sec. LEXIS 3, October 11, 1995.

⁷ See Commissioner's Opinions, File No. OP 6595 CFLL, 1996 Cal. Sec. LEXIS 9, November 5, 1996; and File No. OP 6738 CFLL, 1999 Cal. Sec. LEXIS 1, August 5, 1999.

⁸ See Commissioner's Opinion, File No. OP 5792 CM, 1988 Cal. Sec. LEXIS 11, December 1, 1988. See also Commissioner's Opinion, File No. OP 5862, 1989 Cal. Sec. LEXIS 3, February 24, 1989.

⁹ Subdivision (c) of Section 3.5 of the Article III of the California Constitution specifically prohibits any administrative agency (such as the Department) from declaring:

...a statute unenforceable, or to refuse to enforce a statute on the basis that federal law or federal regulations prohibit the enforcement of such statute unless an appellate court has made a determination that the enforcement of such statute is prohibited by federal law or federal regulations.

oversight and adequate consumer protection that no longer appears warranted and may have been misguided, given the marketplace events of the last decade and the Dodd-Frank Act reversal of state preemption. Consequently, the Department is inviting comments on a proposal that would effectively withdraw these past opinions.

C. End of Federal Preemption

In 1996, the OTS issued regulations which preempted state regulatory efforts over real estate lending activities of federal savings associations and their operating subsidiaries.¹⁰ Subsequently in February 2004, the OCC followed the OTS's lead and "...officially preempted national banks and their operating subsidiaries from state..." lending laws.¹¹ As a consequence, many national banks began to transition their nonbank operating subsidiaries from state-licensed to OCC-regulated lending operations.¹² With the enactment of the Dodd-Frank Act, Congress affirmatively removed the preemptive powers of the OCC over states' ability to regulate and enforce regulatory laws with regard to nonbank operating subsidiaries, affiliates, and agents of banks and savings associations. In light of these changes, the Department's proposed language would amend the regulations implementing the CFLL and the CRMLA to clarify that the exemptions for banks and savings associations set forth in the laws do not extend to operating subsidiaries and affiliates of these institutions, consistent with the Dodd-Frank Act.

INVITATION FOR COMMENT

Existing rules set forth requirements for the licensing and regulation of finance lenders, brokers, residential mortgage lenders, mortgage servicers, and mortgage loan originators. To implement Section 1045 of the Dodd-Frank Act and expressly withdraw the past Commissioner's opinions regarding the breadth of the bank exemptions under the CRMLA and the CFLL, the proposed language clarifies that for purposes of defining an exempt entity not subject to licensure requirements under the CFLL and the CRMLA, a nondepository operating subsidiary, affiliate, or agent as specified is NOT exempt from licensure unless it is a subsidiary affiliate, or agent that is chartered as a national bank or federal savings association. In other words, a nondepository operating subsidiary, affiliate, or agent of a federal savings association is required to be licensed under the CFLL or the CRMLA unless it is a subsidiary, affiliate, or agent that is chartered as a national bank or federal savings association.

¹⁰ Wilmarth, *supra* note 1 at 910.

¹¹ "The Impact of Federal Preemption of State Anti-Predatory Lending Laws on the Foreclosure Crisis," Research Report, Center for Community Capital, Univ. N. Carolina at Chapel Hill, Ding, et al., August 27, 2010, at p. 2. See http://www.ccc.unc.edu/documents/Preemption_final_August%2027.pdf.

¹² Financial Crisis Inquiry Commission Report, *Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States* "Part III: The Boom and Bust: Chapter 7: The Mortgage Machine" at p. 112.

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Comments Requested by May 7, 2014

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In accordance with Government Code Section 11346(b), the Department seeks to involve parties who would be subject to the regulations and other interested parties in discussions regarding the proposed regulations. The Commissioner invites interested parties to review the accompanying draft text and provide comments.

TIME FOR COMMENTS

The Department is providing the attached text of draft regulations to interested parties, and invites interested parties to submit comments on these documents by May 7, 2014. Comments from interested persons will assist the Department in determining whether amendments to regulations under the CFLL and the CRMLA are necessary and appropriate.

This solicitation for comments from interested parties is not a proposed rulemaking action under Government Code Section 11346, and the public will have an additional opportunity to comment on proposed changes if, after consideration of the comments from interested parties, the Department proceeds with a notice of a proposed rulemaking action.

WHERE TO SUBMIT COMMENTS

You may submit comments by any of the following means:

Electronic

Comments may be submitted electronically to regulations@corp.ca.gov. Please identify the comments as PRO 03/13.

Mail

California Department of Business Oversight
Legal Division
Attn: Karen Fong (PRO 03/13)
1515 K Street, Suite 200
Sacramento, CA 95814-4052

Fax

(916) 322-5875

CONTACT PERSON

Questions regarding this invitation for comments may be directed to Colleen Monahan, Senior Counsel, at 916-323-7384 or colleen.monahan@dbo.ca.gov.