

INITIAL STATEMENT OF REASONS
FOR AMENDMENTS TO REGULATIONS UNDER THE
CORPORATE SECURITIES LAW OF 1968
CALIFORNIA FINANCE LENDERS LAW
CALIFORNIA RESIDENTIAL MORTGAGE LENDING ACT
SECURITIES DEPOSITORY LAW

As required by Section 11346.2 of the Government Code, the California Corporations Commissioner (Commissioner) sets forth below the reasons for the proposed amendments to Sections 260.210, 260.211 and 260.211.1 to Article 8 and Section 260.231 to Article 10 of Subchapter 2, Sections 1422, 1422.7 and 1423 to Article 2 and Sections 1581 and 1582 to Article 13 of Subchapter 6, Section 1805.204 to Subchapter 11, and Section 1950.122.8 to Article 2 of Subchapter 11.5; and adoption of Section 1430 to Article 3 of Subchapter 6 of Title 10 of the California Code of Regulations (10 C.C.R. Sections 260.210, 260.211, 260.211.1, 260.231, 1422, 1422.7, 1423, 1430, 1581, 1582, 1805.204, and 1950.122.8).

SPECIFIC PURPOSE OF REGULATIONS

This regulatory action proposes to 1) amend the application forms and information practices and privacy notices under the Corporate Securities Law of 1968, the California Finance Lenders Law, the California Residential Mortgage Lending Act and the Securities Depository Law to notify applicants and licensees that the Department of Corporations may deny or suspend licenses issued to individuals and businesses for failure to pay their California state tax obligation, and to request federal taxpayer identification numbers from business entities for the purpose of identifying delinquent business taxpayers, 2) change the license application form under the California Finance Lenders Law to allow operating subsidiaries of federally chartered banks or financial institutions to obtain licensure, 3) clarify the reporting of past criminal acts and other violations in the license application under the California Finance Lenders Law, 4) amend the California Finance Lenders Law application to eliminate self-certification of investor status, and 5) adopt the annual report form under the California Finance Lenders Law.

Deny or Suspend Licenses of Delinquent Taxpayers

This regulatory action proposes to amend the application forms and information practices and privacy notices under the Corporate Securities Law of 1968, the California Finance Lenders Law, the California Residential Mortgage Lending Act and the Securities Depository Law to request federal taxpayer identification numbers from business entities for the purpose of identifying delinquent business taxpayers, inform applicants and licensees in license applications that their licenses may be suspended if they fail to pay their state tax obligation, and notify applicants in the notices that their social security numbers and federal taxpayer identification numbers will be used to identify certain delinquent taxpayers for the purposes of denying or suspending their licenses.

Assembly Bill 1424 (Chap. 455, Statutes of 2011) provides that state governmental licensing entities shall adopt regulations as necessary to implement the new provisions concerning denying or suspending licenses of delinquent taxpayers (Business and Professions Code Section 494.5(p)). The proposed changes in the regulatory action are necessary to ensure continued compliance under state and federal information privacy laws, and to conform to new state requirements under Assembly Bill 1424.

The Department of Corporations licenses broker dealers, agents of broker dealers and investment advisers under the Corporate Securities Law of 1968; lenders, servicers and brokers under the California Finance Lenders Law and the California Residential Mortgage Lending Act; and securities depositories under the Securities Depository Law. These licensees include individuals (sole proprietors) and business entities.

Assembly Bill 1424 requires state licensing agencies that issue professional or occupational licenses, certificates, registrations, or permits, to suspend or refuse to issue a license when an applicant's or licensee's name is on either the State Board of Equalization's or the Franchise Tax Board's list of the 500 largest tax delinquencies. Among other things, the law requires state licensing agencies such as the Department of Corporations to collect social security numbers or federal taxpayer identification numbers from individuals and business entities who apply for or renew a license, and match the information to the names on the tax delinquencies lists; amend license and renewal license application forms to inform applicants and licensees that their licenses may be suspended if they fail to pay their state tax obligation; and notify applicants and licensees prior to denying or suspending a license.

The Department of Corporations already has similar responsibilities, including requesting social security numbers from individuals (but not business entities) applying for or renewing licenses under Family Code Section 17520 concerning child support. Assembly Bill 1424 increases the Department of Corporations' responsibilities because in addition to checking social security numbers of individuals, the bill requires the Department of Corporations to also request and check federal taxpayer identification numbers of business entities.

Assembly Bill 1424 requires license applications forms of state licensing agencies to include a statement notifying applicants that their licenses may be suspended if they later fail to pay their state tax obligation and requires the Department of Corporations to obtain federal taxpayer identification numbers from business entities for purposes of identifying delinquent business taxpayers. Accordingly, the applications forms under the Corporate Securities Law of 1968 (10 CCR Section 260.231), the California Finance Lenders Law (10 CCR Sections 1422, 1423, 1581, and 1582) and the Securities Depository Law (10 CCR Section 1805.204) need to be amended to comply with Assembly Bill 1424.

In addition, the California Information Practices Act of 1977 (Civil Code Section 1798.17) and the Federal Privacy Act of 1974 (5 U.S.C. § 552a) require the Department of Corporations when requesting personal information, including social security numbers, to notify individuals about whether disclosure of a social security number is voluntary or mandatory and what uses will be made of the information. The Department of Corporations currently requests social security numbers from individuals in license

application forms.

The information practices and privacy notices are included in or as an attachment to license application forms, or in the regulations concerning national uniform application forms. To remain in compliance with California and federal information privacy laws, the notices in the regulations under the Corporate Securities Law of 1968 (10 CCR Sections 260.210, 260.211, 260.211.1 and 260.231), the California Finance Lenders Law (10 CCR Section 1422.7), and the California Residential Mortgage Lending Act (10 CCR Section 1950.122.8) must be amended to inform applicants that their social security numbers and federal taxpayer identification numbers will be used to identify certain delinquent taxpayers for purposes of denying or suspending licenses.

The Department of Corporations also licenses payday lenders under the California Deferred Deposit Transaction Law and escrow agents under the Escrow Law. The application forms in the regulations under these laws also require amendments to conform to Assembly Bill 1424 and these same changes are being proposed in another Department regulatory action.

Change to License Application for Operating Subsidiaries

This regulatory action proposes to amend Section 1422 of the rules, the “Application for a License under the California Finance Lenders Law” (Application), to delete the declaration regarding operating subsidiary status (item number 2 in the Execution Section of the Application), so that an applicant no longer needs to declare that it is not an operating subsidiary of a federally chartered bank or financial institution in order to obtain licensure. This proposed change is necessary because federal law no longer preempts the state from requiring operating subsidiaries of national banks and savings associations to comply with state lending laws.

Under the California Finance Lenders Law, the Department of Corporations licenses and regulates finance lenders and brokers conducting business in this state. The California Finance Lenders Law provides that no person shall engage in the business of a finance lender or broker without obtaining a license from the Commissioner (Financial Code Section 22100). The California Finance Lenders Law further provides that the application for a finance lender or broker’s license shall be in the form and contain the information that the Commissioner may by rule require (Financial Code Section 22101(a)). Section 1422 of Title 10 of the California Code of Regulations contains the Department of Corporations’ Application. This form is used by applicants seeking to become licensed as finance lenders or brokers.

Prior to the federal Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub.L. No. 111-203) (July 21, 2010) 124 Stat. 1376) (“Dodd-Frank Act”), an appellate court ruled that operating subsidiaries meeting certain requirements and doing business under federal laws relating to national banks were not subject to the licensing provisions of the California Finance Lenders Law. (Wells Fargo Bank N.A. v. Boutris, 419 F.3d 949 (CA9 2005).) As a result, the Department of Corporations amended the Application for a license under the California Finance Lenders Law in 2007 to include a requirement that the applicant sign a declaration that the applicant is not an operating subsidiary of a federally chartered bank. However, the Dodd-Frank Act effectively ended preemption for

operating subsidiaries, agents and affiliates of national banks and federal savings associations (12 U.S.C.S. § 25(b)). Effective July 21, 2011, operating subsidiaries of national banks and thrifts are no longer preempted from state licensing laws.

Currently in the regulations under the California Finance Lenders Law, the applicant is required to sign a declaration in the Application, providing among other things, “[t]hat the applicant is not an operating subsidiary of a federally chartered bank or financial institution that is subject to oversight by the federal regulatory agency in accordance with federal law (12 U.S.C. §1 et seq.)” The change proposed in this regulatory action will delete this statement as a result of the change in federal preemption law.

Clarify When to Report Past Criminal Acts and Other Violations in the California Finance Lenders Law Application

The regulatory action proposes to amend question number 7 of the Application to clarify that disclosure in the Application is 1) limited to the past 10 years for criminal convictions or acts involving dishonesty, fraud or deceit, and 2) not limited to any time period for violations of the California Finance Lenders Law or regulations, or other similar regulatory schemes, e.g., applicants must report any and all of these violations. The proposed change is necessary to ensure that applicants understand the disclosure requirements and the Department of Corporations receives complete information in deciding whether to issue or deny an application.

Under the California Finance Lenders Law, the Commissioner may deny an application for a finance lender or broker license if the applicant has within the last 10 years been convicted of or pleaded nolo contendere to a crime, or committed an act involving dishonesty, fraud, or deceit substantially related to the qualifications and functions of lending, brokering or servicing of loans under the law, or if the applicant has violated the California Finance Lenders Law or regulations, or other similar regulatory scheme at any time (Financial Code Section 22109(a)(2) and (3)). Currently, question number 7 does not identify the period of time in which to report on the information and does not make clear that the reporting periods are different for past crimes and acts, and for regulatory violations.

Background Checks on Passive Investors Under the California Finance Lenders Law

The regulatory action proposes to delete from the Application the self-certification for passive investors concerning background investigations. The California Finance Lenders Law requires a background investigation to be conducted on all principal officers, directors, general partners, managing members and persons owning or controlling, directly or indirectly, 10% or more of the outstanding interest or equity securities of the applicant (Financial Code Section 22105). If the person directly owning or controlling 10% or more of the applicant is an entity, the entity’s principal officers, directors, general partners, managing members and persons owning or controlling 10% or more of that entity are also subject to background investigation under Financial Code Section 22105.

The purpose of the law is to protect the public by ensuring that applicants and those associated with applicants who are responsible for the lending activities, possess the qualifications, character and fitness to engage in finance lending.

Some entities owning 10% or more of an applicant are merely investors such as pension plans, and are not responsible for the applicant's lending activities. Conducting a background investigation of these "passive" investors is burdensome and costly to the entity, and does not further the intent of the law. Accordingly, the instructions to Exhibit C in the Application were amended in 2007 to permit passive investors to self-certify that they are not responsible for the applicant's lending activities and therefore it is unnecessary to investigate the entity's owners or control persons under Financial Code Section 22105.

The self-certification has been subject to abuse by some applicants attempting to use it to evade background investigations or to hide the true identity of the owner(s). Accordingly, the proposed change deleting self-certification for passive investors is necessary because it will make it more difficult to conceal the identity of persons who actually own or are responsible for the lending activities of an applicant, and make it harder for them to evade background checks. The proposed change will continue to provide the Department of Corporations with the necessary discretion to waive background investigations of passive investors when doing so is consistent with the intent of the law.

Adopt Annual Report Form Under the California Finance Lenders Law

The regulatory action proposes to adopt the annual report form to Section 1430 of the California Finance Lenders Law rules. Licensees are required to file an annual report on the form prescribed by the Commissioner, by March 15, providing information on business and operations conducted under the California Finance Lenders license (Financial Code Section 22159). The information reported in the annual report is used to determine the licensee's compliance with financial requirements and to calculate the amount of the annual assessment owed to the Department of Corporations by each licensee. The information reported by licensees in the annual report is also used collectively to publish the Department of Corporations' annual report on the operation of finance companies.

The annual reporting requirement is not a new requirement and the Department of Corporations has been requiring licensees to file an annual report on the prescribed or similarly prescribed form since at least 1994. The proposed action merely seeks to correct an oversight by adopting the annual report by rulemaking, and does not impose additional filing or reporting requirements on licensees. The proposed change is necessary to ensure that potential applicants are fully informed of all reporting and disclosure requirements before they decide to apply for a license, and to comply with California's administrative rulemaking requirements.

In addition, this regulatory action proposes additional nonsubstantive changes related to grammar, editing, and punctuation in Sections 1422, 1423, 1581, 1582 and 1805.204 of the rules, including renumbering the remaining items in the execution section of the Application.

BENEFITS ANTICIPATED FROM REGULATORY ACTION

The benefits anticipated from this regulatory action include monetary benefits to California from strengthening the state's tax collection powers, and protecting general welfare and promoting fairness and equity by making it more difficult for some individual and businesses to avoid paying their fair share of taxes (Business and Professions Code Section 494.5(o)). The anticipated benefits also include nonmonetary benefits derived from promoting a fair and level playing field among lenders, by allowing operating subsidiaries to apply for state licensure for lending activities in California, and protecting the public by identifying and investigating all persons responsible for the lending activities of a license applicant. Further, by adopting the annual report form, the regulatory action increases transparency in government through compliance with California's administrative rulemaking requirements.

ECONOMIC IMPACT ANALYSIS

The Commissioner has made an initial determination that the proposed regulatory action empowering the Department of Corporations to deny or suspend licenses of delinquent taxpayers will not have a significant adverse impact on business, and may on the contrary have a positive impact on California's general economy, and capital and labor markets. The Franchise Tax Board estimates an annual gain of \$19 million in fiscal year 2011-12, \$24 million in 2012-13, and \$26 million in 2013-14 from Assembly Bill 1424 (Assembly Floor analysis of Assembly Bill 1424, as amended September 2, 2011). In light of the importance of California's economy, and capital and labor markets, the proposed regulation would also likely impact the health and general welfare of California residents. According to the Legislature's analysis, Assembly Bill 1424's provisions balance the state's need to collect taxes with the taxpayers' need to earn a living to pay off their tax debts.

The proposed regulatory changes clarifying information required from an applicant in the application for a finance lender or broker and adopting the existing annual report helps ensure that the Department of Corporations receives correct and complete information for regulatory purposes, and better identifies changing economic conditions in the finance lending industry in California. Accordingly, these changes will not create or eliminate jobs, or impact existing businesses. Further, the Department of Corporations does not anticipate that the proposed regulatory change allowing bank operating subsidiaries to do business in California under a state license would affect the creation of jobs or impact existing businesses in California. According to informal industry speculation, bank operating subsidiaries may likely restructure to avoid state licensure.

Other than the report cited in this section, the Department of Corporations has not relied upon any other reports or facts to support the initial determination that the regulation will not have a significant adverse economic impact on business, or any other impact described in Government Code Section 11346.3.

TECHNICAL, THEORETICAL AND/OR EMPIRICAL STUDIES, REPORTS OR DOCUMENTS

Other than report cited in the Economic Impact Analysis, the Department of Document PRO 18/11 C (Initial)

Corporations did not rely upon any technical, theoretical, or empirical study, report, or other similar document in proposing this regulatory action. The report is on file with the Department of Corporations.

REASONABLE ALTERNATIVES AND REASONS FOR REJECTING THOSE ALTERNATIVES

In accordance with Government Code section 11346.5, subdivision (a)(13), the Department of Corporations must determine that no reasonable alternative it considered to the regulation or that has otherwise been identified and brought to its attention would either be more effective in carrying out the purpose for which the action is proposed or would be as effective and less burdensome to affected private persons or would be more cost-effective to affected private persons and equally effective in implementing the statutory policy or other provision of law than the proposal described in this Initial Statement of Reasons.

REASONABLE ALTERNATIVES THAT WOULD LESSEN ANY ADVERSE IMPACT ON SMALL BUSINESSES

No reasonable alternative considered by the Department of Corporations or that have otherwise been identified and brought to the attention of the Department of Corporations would be as effective and less burdensome to affected private persons, or would lessen any adverse impact on small business.

FACTS, EVIDENCE, DOCUMENTS, TESTIMONY OR OTHER EVIDENCE RELIED ON BY AGENCY

The proposed regulatory action will not have a significant adverse economic impact on business because the regulations merely clarify and update existing requirements, and make other requirements consistent with changes in state and federal law. Other than the report identified in the Economic Impact Analysis, the Department of Corporations has not relied on any facts, evidence, documents, testimony or other evidence in developing this proposed regulatory action.

REPORT REQUIREMENT

This proposed rulemaking action sets forth a requirement for businesses to file a report. In accordance with Government Code Section 11346.3(d), the Department of Corporations finds that the report is necessary for the health, safety or welfare of the people of the state.

STATE REGULATIONS NOT DUPLICATIVE OF FEDERAL/STATE LAW

The proposed regulatory action empowering the Department of Corporations to deny an occupational license application or suspend a license is consistent with the provisions of Assembly Bill 1424, state and federal information privacy laws, and existing state law and regulations that require the Department of Corporations to deny or suspend a license for an individual's failure to satisfy child support financial obligations. In addition, the proposed regulatory action deleting the applicant's declaration denying operating

subsidiary status facilitates the ability of operating subsidiaries to obtain state licensure for lending activities, and the proposed regulatory action deleting the self certification for passive investors better ensures that only applicants who possess the requisite qualifications, character and fitness obtain a lending license. Both of these changes are consistent with the California Finance Lender Law regulations. Further, the proposed regulatory action adopting the annual report form is compatible with the purpose and requirements of state administrative rulemaking. According, the proposed amendments are not inconsistent or incompatible with existing state regulations.