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TO: Commissioner
Legal Division
Department of Business Oversight
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From: Dennis Brown
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RE: Request for an Interpretive Opinion

The Equipment Leasing and Finance Association (ELFA) represents financial services companies and manufacturers in the commercial equipment lease finance sector. Many of our members accept referrals from brokers. ELFA requests on behalf of our association members an interpretive opinion to each of the questions presented below concerning implementation of Senate Bill 197. This request conforms to Interpretive Request requirements outlined in Department of Business Oversight Release No. 61-C (Revised) on May 28, 2014, as ELFA members would in some cases be principal parties to the prospective transactions cited, legal analysis applicable to the facts is presented, this request poses specific prospective legal questions and responses from the Department of Business Oversight will be distributed industrywide for reliance when seeking to comply.

Intrastate versus interstate transactions involving a broker, lender and/or vendor within or outside California has raised questions about the interstate reach of this revision to Lenders License law. This is amplified because qualifying to do business in California and requirements to have a lender's license appear set against each other.

As background on the questions below, the California Model Business Corporation Act contains the standard provision that a corporation (or an LLC under a companion statute) is not doing business in California if it is transacting business in interstate commerce. Corporations Code §2501(a), §191(a) and §191(c)(6) are among indicators that if you are not conducting intrastate business in California, you need not obtain from the Secretary of State a certificate of qualification.

With certain exceptions, under Fin. C. §22100 a finance lender or broker must be licensed before transacting business in California, with §22009 citing consumer and commercial loans. Senate bill 197 seeks further restrictions on loans to small business. There is a conflict in law: The application for the lender's license requires that the licensee be qualified to do business in California. Complexities that small independent broker's encounter to obtain a California Finance Lenders License is legend with durations of 9 months or more often cited. Annual administration forms completed by them are extremely challenging, time consuming and results in no value as they enter literally 0 for every category. This convergence of Lenders License requirements with the Corporations Code is perplexing to our members engaging intrastate and interstate transactions.

The above information provides legal background applicable to the facts presented in prospective questions offered below. These questions when taken together with examination of applicable law presented above offer facts sufficient for interpretive opinions.

Questions:

A licensed lender gaining referrals from a licensed broker is unaffected by this legislation. Correct?

What about unlicensed dealers that are not compensated. For example, suppose a large commercial truck dealership prepares and handles paperwork for the finance company without compensation because it assures financing for the dealer's sales. 22602 (c) states in part: "The following activities by an unlicensed person are not authorized by this section" Note that (c) does not state whether the activities only apply to compensated persons. Is "the section" limited to compensated activities? If the only amount received by the dealer is the margin on the sale of the equipment, would this be considered as "compensation" within the meaning of the statute? Which activities, if any, by an unlicensed person are permissible (without compensation) and which are clearly prohibited?

Furthermore, assume a situation where the large commercial truck manufacturer provides compensation to the dealer (and the dealer's sales personnel) from time to time in the form of certain sales incentives. The truck manufacturer has a finance subsidiary which maintains a finance lender's license. The dealer provides the activities outlined in 22602(c) to facilitate the sale and financing of the truck. Are these activities permissible by the unlicensed dealer (or sales personnel) without additional compensation provided by the finance subsidiary?

Connecting the dealer issue to common marketplace transactions, please respond to the following interrelated questions:

1. State A is not California. Dealer in State A will deliver equipment to State A to be used in State A. The customer is a California corporation and the finance lease documents are signed by the customer in California. Is the transaction subject to the compensation restrictions of the CFLL?
2. Dealer and Customer are from State A and the equipment is delivered and used in California. Is the transaction subject to the compensation restrictions of the CFLL?

The California Lender Law (Financial Code Section 22007) only applies to a "licensee" defined as a "finance lender": one "who is engaged in the business of making... commercial loans", meaning actually being on the loan (Financial Code Section 22009). A "broker" is defined as "one who is engaged in the business of negotiating or performing any act as broker in connection with loans made by a finance lender" (Financial Code Section 22004) including filling-in forms, and getting the customer's signatures on contracts whether the broker is on the loan or not. There is an assumption the broker is paid and therefore falls under restrictions of the new law. But if the "broker" is not paid does Senate Bill 197 govern their activities?

Is the notice to prospective borrowers under Section 22603 of the California Finance Lenders Law *required* to be given to *any* prospective borrower who has been referred by an unlicensed person, *regardless* of whether the unlicensed referring party is to receive a fee or other compensation for such referral? This would require licensed California finance lenders to notify applicants that "we may pay a fee to [Name of Unlicensed Person] for the successful referral," even if no fee is to be paid, which could be a cause of confusion and misunderstanding.

Small independent brokers serve the small business community nationally as a conduit for small business lending. If a California business needing equipment and/or financing gets an East Coast lender that has both a California lender license and a foreign corporation license through an East coast broker that has neither a California lenders license or a California foreign corporation license, and the transaction is completed on the East Coast without the lender or the broker ever entering the state, and documents are sent via mail or email, is the broker doing business in California? If so, can the broker participate in the transaction under the "umbrella" of both the lender's California lender license, and its California foreign corporation license so that the broker does not have to get its own foreign corporation license? Allowing the broker to piggyback on the lender's licenses would seem to track the intent expressed by the Department to ease the flow of deals.

If a small business borrower is in California, can a licensed funder pay a commission on a loan to that borrower brokered by an unlicensed broker located outside California without complying with the requirements of the statute including the disclosures and restrictions? How would such expansion into interstate commerce be justified?

The preceding questions simplify complexity of the commercial finance marketplace. Please explain requirements for each party in a transaction for a broker in Alabama to get paid for a loan to a California company, made by a Minnesota lender to finance equipment sold by a New York vendor? Must the broker must be licensed and therefore be qualified as a foreign corporation?

Do you agree a bank or related entities including bank owned affiliates, subsidiaries and bank holding company acquisitions for purpose of commercial lease financing can pay a commission to an unlicensed broker?

May nonbank subsidiaries and affiliates of national banks (including affiliates of federal savings associations) compensate unlicensed persons for the activities listed in 22602(c)?

Are nonbank subsidiaries and affiliates of national banks (including affiliates of federal savings associations) exempt from the licensing requirements of the California Finance Lenders Law?

The law does not appear to limit itself to unlicensed brokers but instead "unlicensed persons" is the term used. Does this mean the "person" does not need to be a "broker" for this new law to apply? Does this mean that any time a licensed lender pays a fee to anyone (e.g. a vendor or reseller), that the lender must comply with the conditions set out in the law?

What if I have a website that collects basic information from customers on behalf of client lenders who subscribe for the opportunity to quote and write transactions for the folks I attract? Am I a broker for the purposes of this law? I'm doing essentially what a broker does.

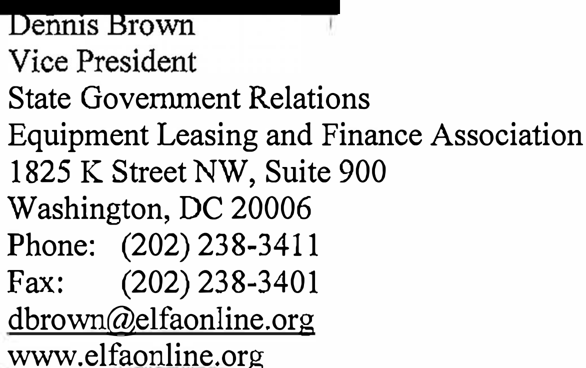
If a licensed lender pays a commission to a broker who is not located in California, is the lender obligated to ensure that the broker is licensed, has brokered less than 5 transactions or is otherwise exempt? Does the law expand the lender's duties so that it cannot pay a commission to any person whether or not that person is required to have a license, unless the loan complies with the stated safe harbor rules (36% interest, etc)? Can the lender rely on a broker's representation that it has a license? That it is exempt (has brokered less than 5 California loans)?

What is the rationale for distinguishing when an unlicensed party refers a deal that the unlicensed party, who is to be paid by the lender in most cases, for the "referral" can't participate in loan negotiation, counseling or advising, prep or gathering loan docs, obtaining signatures, like? That will distort market functioning and economics for California borrowers.

Conclusion:

Small business lenders throughout the U.S. are utilizing credit scoring models that do not involve cash flow analysis and/or net worth or other specific financial information. This is the whole nature of "fintech" and the evolution of small business credit. This enactment of law turns the clock back by constricting credit and raising its cost by dictating underwriting and risk management techniques and process. This change has potential to shut down much small business credit that is not underwritten with financial statements. Licensing should not place restrictions on a proven manner of transacting credit nor requirements on how to evaluate and process credit. Those are inherent risks in the credit and finance industry that each lender is responsible for.

Taken as a whole, restrictions implemented by this revision to the California Finance Lenders License law mean the cost of doing business for lessors handling transactions with small business will increase as a result of this bill if (a) the lender/lessor cannot utilize vendors to transmit documents and gather information and (b) have to do extensive credit checks with financial statements on each prospective borrower/lessee. In addition, this will slow down the time for approval when sometimes it is necessary for the borrower or lessee to acquire equipment as soon as possible to preserve a competitive advantage in the marketplace for the small business. Attempting to extend this unique administrative forest within the state and prospectively nationwide simply means fewer brokers will continue doing business with small business in California thereby restricting access of small business to needed finance. Your interpretive responses to our questions will help gain a better understanding.



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