

## Senate Bill No. 197

### CHAPTER 761

An act to add Sections 22602, 22603, and 22604 to the Financial Code, relating to **finance lenders**.

[Approved by Governor October 10, 2015.  
Filed with Secretary of State October 10, 2015.]

### LEGISLATIVE COUNSEL'S DIGEST

SB 197, Block. **Finance lenders**: commercial loan: referral.

Existing law, the California **Finance Lenders** Law, provides for the licensure and regulation of **finance lenders** by the Commissioner of Business Oversight. Existing law makes a willful violation of the law by any person a crime. Existing law defines a **finance lender** as any person who is engaged in the business of making consumer loans or commercial loans. Existing law defines a commercial loan as a loan of a principal amount of \$5,000 or more, or any loan under an open-end credit program, whether secured by either real or personal property, or both, or unsecured, the proceeds of which are intended by the borrower for use primarily for purposes other than personal, family, or household.

This bill would authorize a licensed finance lender to compensate an unlicensed person in connection with the referral, as defined, of one or more prospective borrowers to the licensee for a commercial loan if certain requirements are met. These requirements would include, among other things, that the referral leads to the consummation of a commercial loan, the loan contract provides for an annual percentage rate that does not exceed a certain percentage, the licensed finance lender obtains documentation from the prospective borrower documenting the borrower's commercial status, and that the licensee maintains records of compensation paid to an unlicensed person, as specified. The bill would make a licensee paying compensation to an unlicensed person in connection with a referral liable for any misrepresentation made to a borrower in connection with that loan made to that borrower by that licensee. The bill would authorize the commissioner to adopt regulations imposing conditions on this referral activity, as specified. The bill would also require a licensed **finance lender** who receives an application for a commercial loan from a prospective borrower who has been referred by an unlicensed person to provide a

specified statement to the borrower regarding the referral arrangement. The bill would prohibit any person receiving compensation in connection with a referral that leads to the consummation of a commercial loan from engaging in specified acts and would authorize the commissioner to order this person to desist and refrain from engaging in the business or further violating those provisions governing such referral.

By creating new requirements, the willful violation of which would be a crime, the bill would impose a state-mandated local program.

The California Constitution requires the state to reimburse local agencies and school districts for certain costs mandated by the state. Statutory provisions establish procedures for making that reimbursement.

This bill would provide that no reimbursement is required by this act for a specified reason.

#### DIGEST KEY

Vote: majority Appropriation: no Fiscal Committee: yes Local Program: yes

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#### BILL TEXT

THE PEOPLE OF THE STATE OF CALIFORNIA DO ENACT AS FOLLOWS:

#### **SECTION 1.**

Section 22602 is added to the Financial Code, to read:  
22602.

(a) A licensee that is a **finance lender** may pay compensation to a person that is not licensed pursuant to this division in connection with the referral of one or more prospective borrowers to the licensee, when all of the following conditions are met:

(1) The referral by the unlicensed person leads to the consummation of a commercial loan, as defined in Section 22502, between the licensee and the prospective borrower referred by the unlicensed person.

(2) The loan contract provides for an annual percentage rate that does not exceed 36 percent.

(3) Before approving the loan, the licensee does both of the following:

(A) Obtains documentation from the prospective borrower documenting the borrower's commercial status. Examples of acceptable forms of documentation include, but are not limited to, a seller's permit, business

license, articles of incorporation, income tax returns showing business income, or bank account statements showing business income.

(B) Performs underwriting and obtains documentation to ensure that the prospective borrower will have sufficient monthly gross revenue with which to repay the loan pursuant to the loan terms, and does not make a loan if it determines through its underwriting that the prospective borrower's total monthly expenses, including debt service payments on the loan for which the prospective borrower is being considered, will exceed the prospective borrower's monthly gross revenue. Examples of acceptable forms of documentation for verifying current and projected gross monthly revenue and monthly expenses include, but are not limited to, tax returns, bank statements, merchant financial statements, business plans, business history, and industry-specific knowledge and experience. If the prospective borrower is a sole proprietor or a corporation and the loan will be secured by a personal guarantee provided by the owner of the corporation, a credit report from at least one consumer credit reporting agency that compiles and maintains files on consumers on a nationwide basis shall also be considered.

(4) The licensee maintains records of all compensation paid to unlicensed persons in connection with the referral of borrowers for a period of at least four years.

(5) The licensee annually submits information requested by the commissioner regarding the payment of compensation in the report required pursuant to Section 22159.

(b) A licensee that pays compensation to a person that is not licensed pursuant to this division in connection with a referral for a commercial loan made by that licensee to a borrower shall be liable for any misrepresentation made to that borrower in connection with that loan.

(c) The following activities by an unlicensed person are not authorized by this section:

(1) Participating in any loan negotiation.

(2) Counseling or advising the borrower about a loan.

(3) Participating in the preparation of any loan documents, including credit applications.

(4) Contacting the licensee on behalf of the borrower other than to refer the borrower.

(5) Gathering loan documentation from the borrower or delivering the documentation to the licensee.

(6) Communicating lending decisions or inquiries to the borrower.

(7) Participating in establishing any sales literature or marketing materials.

(8) Obtaining the borrower's signature on documents.

(d) The prohibitions in subdivision (c) do not apply if the unlicensed person meets one or more of the following criteria:

(1) Is exempt from licensure under this division.

(2) Is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code.

(3) Is a business assistance organization recognized by the United States Small Business Administration.

(4) Is engaged in one or more of the activities described in paragraphs (1) to (8), inclusive, of subdivision (c) in connection with five or fewer commercial loans in a 12-month period made by persons licensed under this division.

(e) The commissioner may adopt regulations under this section to impose conditions on the referral activity authorized under this section. The commissioner may classify persons, loans, loan terms, referral methods, and other matters within his or her jurisdiction, and may prescribe different requirements for different classes of loans.

(f) Nothing in this section shall authorize the payment of a referral fee to an unlicensed person for a residential mortgage loan, nor the payment of a referral fee to a person required to be licensed under Section 10131 or 10131.1 of the Business and Professions Code, unless such person is licensed by the Bureau of Real Estate pursuant to Division 4 (commencing with Section 10000) of the Business and Professions Code.

(g) For the purposes of this section, "referral" means either the introduction of the borrower and the **finance lender** or the delivery to the **finance lender** of the borrower's contact information.

## **SEC. 2.**

Section 22603 is added to the Financial Code, to read:

**22603.**

A licensee that is a **finance lender** shall provide a prospective borrower who has been referred by an unlicensed person the following written statement, in 10-point font or larger, at the time the licensee receives an application for a commercial loan, and shall require the prospective borrower to acknowledge receipt of the statement in writing:

"You have been referred to us by [Name of Unlicensed Person]. If you are approved for the loan, we may pay a fee to [Name of Unlicensed Person] for the successful referral. [Licensee], and not [Name of Unlicensed Person] is the sole party authorized to offer a loan to you. You should ensure that you understand any loan offer we may extend to you before agreeing to the loan terms. If you wish to report a complaint about this loan transaction, you may contact the Department of Business Oversight at 1-866-ASK-CORP (1-866-275-2677), or file your complaint online at [www.dbo.ca.gov](http://www.dbo.ca.gov)."

**SEC. 3.**

Section 22604 is added to the Financial Code, to read:

**22604.**

(a) Any person that receives compensation in connection with a referral, as described in Section 22602, that leads to the consummation of a commercial loan under this division may not do any of the following:

(1) Make a materially false or misleading statement or representation to a prospective borrower about the terms or conditions of a prospective loan.

(2) Advertise, print, display, publish, distribute, or broadcast any statement or representation with regard to the conditions for making or negotiating a loan that is false, misleading, or deceptive, or that omits material information that is necessary to make the statements made not false, misleading, or deceptive.

(3) Engage in any act in violation of Section 17200 of the Business and Professions Code.

(4) Commit an act that constitutes fraud or dishonest dealings.

(5) Fail to safeguard a prospective borrower's personally identifiable information.

(b) For purposes of this section, "personally identifiable information" means information that is not publicly available, that a prospective borrower provides for the purpose of obtaining a loan or other financial product.

Personally identifiable information includes information a prospective borrower provides on an application to obtain a loan, credit card, or other financial product or service.

(c) Whenever, in the opinion of the commissioner, any person is engaged in the business of soliciting borrowers for a loan to be made by a licensee under this division, and the person is not in compliance with this section, Section 22602, Section 22603, or any other provision of this division authorizing such activity or exempting the person from this division, the commissioner may order the person to desist and to refrain from engaging in the business or further violating this division.

#### **SEC. 4.**

No reimbursement is required by this act pursuant to Section 6 of Article XIII B of the California Constitution because the only costs that may be incurred by a local agency or school district will be incurred because this act creates a new crime or infraction, eliminates a crime or infraction, or changes the penalty for a crime or infraction, within the meaning of Section 17556 of the Government Code, or changes the definition of a crime within the meaning of Section 6 of Article XIII B of the California Constitution.

## **Electronic Signatures and Chattel Paper Perfection**

### **Part One**

We are going to address this issue in two parts. Several of our clients have asked over the past few months about this scenario:

1. Lessee manually signs lease (or EFA) and sends the signed copy to Lessor by fax or as an attachment to an email. By "manually signs", we mean that the lessee signs by hand with a "wet" signature, as opposed to signing electronically by typing in a code that inserts a digital signature into an electronic document.
2. Lessor prints and signs the copy sent to it and takes this to its bank or other funder for discounting. Lessee (presumably) destroys the copy with its signature.

As defined by UCC Section 9-102, a lease, like a security agreement, is chattel paper. Under UCC Sections 9-312 and 9-313, a security interest in chattel paper can be perfected by filing a UCC financing statement OR, in the case of tangible chattel paper, by possession of the tangible chattel paper.

In the case of electronic chattel paper, Section 9-314 provides that, in lieu of possession, control of electronic chattel paper perfects the secured party's security interest under 9-105 control means control of the single authenticated record - the one with the digital signature that most commonly goes to a secure electronic vault . Without belaboring the issue, a piece of paper with a faxed or copied signature is tangible chattel paper and not electronic chattel paper for these purposes.

Looking back at the rules regarding tangible chattel paper, we still have a question: if one party perfects by filing and the other by possession...who wins? Does a bank taking assignment of a lease from a lessor have to do a UCC check? What if there is a blanket lien on the lessor? The answer is in UCC Section 9-330(b), which provides that possession wins over filing where tangible chattel paper is concerned.

OK, so possession of what? Comment 4 to 9-330 makes it clear that, in cases where there may be multiple copies (counterparts) of tangible chattel paper, each of which could be signed and therefore, "original", the parties may designate one as the "original chattel paper." Moreover, under 9-330(b), in order to defeat a competing interest in chattel paper, a creditor must act in good faith and "without knowledge that the purchase [of the chattel paper] violates the rights of the secured party." In other words, if the lease itself warns a prospective other creditor that the copy it is getting is not the right one, it loses its claim of priority.

For many years, it has been common practice to label one of the manually-signed copies the "sole original counterpart" or "sole original" or something similar. Many lessors only allow the lessee to sign one copy and then sign that copy and mark it as the original.

Here is where the problem comes in: If the copy signed by the lessee is floating around somewhere, what is to prevent the lessor fraudulently, or accidentally, signing it as well as the received fax or emailed copy? If two or more funders show up with the same lease, it seems at least probable that the one with two manual signatures will be considered the "original."

What to do? Control of electronic chattel paper by funders and possession manually signed, wet signature tangible chattel paper is at least equally safe and almost universally accepted. More and more banks are getting comfortable with electronic vaults and systems to create control. Courts are routinely enforcing and becoming more familiar with authentication of these electronic documents as well. This hybrid of tangible paper with a duplicate signature electronically transmitted, however, raises problems.

As noted, comment 4 to 9-330 allows the parties to the original transaction

to designate which copy is the original for chattel paper perfection purposes. Therefore, it would seem that a funder should be comfortable with an arrangement under which the copy in its hands matches the language of the lease. In other words, the lease itself should identify the original chattel paper to be held in the funder's possession.

One proposal would be to provide that there is no chattel paper original and that perfection of a security interest in the lease may only be by filing, not possession. In the case of active lessors, that would seem impractical, but a funder who files a blanket lien with no security interest ahead of it might feel protected. This works well if there will be only one funder used by the lessor...which is not the usual case.

Another possibility is simply to provide that the lessor represents to the funder that it will only sign and designate one copy as the original, and this is the one it will deliver to the funder. This leaves the funder at risk for fraud by the lessor itself, but, in the case of reputable, creditworthy lessors, this may be the best option available.