

*** HEARING POSTPONED ***

**ASSEMBLY BUDGET SUBCOMMITTEE NO. 4 ON STATE ADMINISTRATION
AND
ASSEMBLY BANKING AND FINANCE COMMITTEE**

ASSEMBLYMEMBERS JIM COOPER, MONIQUE LIMÓN, CHAIRS

~~WEDNESDAY, MARCH 18, 2020~~

~~4 P.M. - STATE CAPITOL, ROOM 127~~

~~(PLEASE NOTE ROOM CHANGE)~~

Informational Hearing

Governor's 2020 Proposal on Consumer Financial Protection and Innovation

I. Introduction from Chair and Members

II. Governor's Proposal on Consolidation of Regulation and Perspectives from Current Licensing Agencies

- Manuel P. Alvarez, Commissioner, Department of Business Oversight
- Helen Kerstein, Principal Fiscal & Policy Analyst, Legislative Analyst's Office
- Kimberly Harbison, Principal Program Budget Analyst, Department of Finance

III. Public Comment

INFORMATION ONLY

1700 DEPARTMENT OF BUSINESS OVERSIGHT

ISSUE 1: CALIFORNIA CONSUMER FINANCIAL PROTECTION AND INNOVATION

The Governor's budget includes resources and trailer bill language to rename the Department of Business Oversight (DBO) to the Department of Financial Protection and Innovation (DFPI), expand and restructure the department and its main funds, and modify the regulation of industrial banks.

BACKGROUND

The federal Consumer Financial Protection Bureau (CFPB) was established to enforce consumer rights, monitor markets and identify patterns of abuse, and listen to and educate consumers. According to the Governor, the federal government's rollback of the CFPB leaves Californians vulnerable to predatory businesses and leave companies without clarity they need to innovate.

Currently, the DBO regulates certain financial services and oversees state-licensed financial institutions, including banks, credit unions, and money transmitters. DBO also licenses and regulates securities brokers and dealers, investment advisers, payday lenders, mortgage lenders, escrow agents, student loan servicers, and other commercial and consumer lenders.

Governor's Trailer Bill Language

The Governor proposes trailer bill language to authorize DFPI to carry out various new responsibilities and activities. Under the Governor's proposal, these various statutory changes would be referred to as the California Consumer Financial Protection Law (CCFPL). Specifically, the proposed language authorizes DFPI to:

1. *Perform Broad Range of Activities Related to UDAAPs.* The proposal authorizes DFPI to investigate and take enforcement actions (such as assessment of administrative penalties and filing of civil lawsuits) against any provider of financial products or services to California consumers, small businesses, nonprofits or family farms for unfair, deceptive, or abusive acts or practices (UDAAPs). The proposal authorizes the department to define UDAAPs through the regulatory process, as well as prescribe rules aimed at preventing UDAAPs. Finally, the proposal generally prevents the courts from enjoining DFPI's enforcement orders in order to prevent them from taking effect.
2. *Conduct Certain Additional Activities.* The proposal grants the commissioner explicit authority to engage in various activities, such as (1) investigating,

researching, analyzing, and reporting on markets for financial products and services, (2) developing and implementing outreach and education programs to underserved customers and communities, and (3) developing and implementing initiatives to promote innovation, competition, and consumer access within financial services.

3. *Possess Broad Regulatory Authority Related to Existing Consumer Protection Laws.* In addition to the regulatory authority described above, the proposal authorizes DFPI to (1) promulgate regulations interpreting and implementing a wide range of existing California laws related to consumer protection and (2) examine entities for compliance with those regulations. The proposed language specifies that, when DFPI and another department have joint authority over these consumer protection laws, DFPI shall consult with the relevant departments at certain points during the process of promulgating regulations.
4. *Require Financial Service Providers to Register.* The Governor's proposal authorizes DFPI to require entities providing financial products or services to California consumers to register with the department. The department indicates that it anticipates registering all providers of consumer financial products or services that are not currently registered with or licensed by DBO or another state department. These providers are known as new covered persons or NCPs. Under the proposed language, DFPI would have the authority to require registrants to file various reports, submit to background checks, and pay registration fees, which the department may set by regulation. Additionally, the department could specify rules of conduct for these entities by regulation.
5. *Restructure Department and Its Main Funds.* The Governor proposes to restructure the department in ways that would effectively eliminate the distinction between its two licensing divisions—DFI and DOC. The proposed language also merges the two main funds that support the department—the State Corporations Fund and Financial Institutions Fund—into a new fund known as the Financial Protection Fund (FPF). (The department's two other small funds—the Credit Union Fund and the Local Agency Deposit Security Fund—would remain separate.)
6. *Modify Regulation of Industrial Banks.* The Governor's proposed budget trailer legislation also changes the requirements for entities to own an industrial bank. The key differences between an industrial bank and commercial bank licensed in California are (1) an industrial bank cannot offer demand deposit (aka checking) accounts and (2) an industrial bank's parent company is exempt from the federal Bank Holding Company Act. Pursuant to SB 2148 of 2000, industrial banks are subject to the same laws, regulations, and examinations as commercial banks in California. Under current law, only entities involved exclusively in financial activities can control an industrial bank. The proposed language instead only requires that

entities controlling industrial banks be *predominately engaged* in financial activities, defined as generating at least 85 percent of revenue from financial services.

7. *Provide Emergency Regulation Authority.* The proposed language provides DFPI with the authority to promulgate emergency regulations to implement the CCFPL. As a result, regulations to implement the above changes would go into effect on a shorter time line and be subject to less up-front public input.

Funding Resources in the 2020-21 Budget

The Governor proposes \$10.2 million and 44 positions in 2020-21 — increasing to \$19.3 million annually and 90 positions in 2022-23 - for DFPI from the proposed FPF. These resources are intended to support the implementation of the CCFPL. In addition, the funding would allow the department to establish the following new offices:

- Financial Technology Innovation Office. Research new innovative technologies and trends and encourage innovation related to financial industries
- Market Monitoring, Consumer Research, Insights and Analytics Office. Provide reports on a variety of topics, such as market trends and consumer behavior.
- Targeted Consumer Outreach and Education Office. Develop educational materials and web tools to educate consumers and conduct outreach to schools and universities on financial education.

The administration indicates that the resources to support these activities would be derived from two different sources within the new FPF. Initially, the department plans to use funds from settlements of previous enforcement actions to support these activities. (These settlement funds are currently in the State Corporations Fund and Financial Institutions Fund, which would be consolidated into the proposed FPF.) On an ongoing basis, the department plans to fund these activities from registration fees DFPI would be authorized to collect under the Governor's proposal, as well as future settlement funds.

STAFF COMMENT

There is general support for improving consumer protection related to financial products and services at the state level. The Governor's trailer bill proposal raises a number of issues that the joint committee will have to explore and examine.

The joint committee may wish to ask DBO the following:

1. How does the department plan to balance their current workload with the new workload included in this proposal? How will the new UDAAP rules affect existing licensees?

2. How should the legislature balance providing enough authority to DFPI to address the evolving market while protecting the legislature's role of legislating future aspects of this market?
3. What authority under the federal UDAAP law does the Department of Justice, District Attorneys and the DBO have to exercise oversight and enforcement? How does this authority differ from the authority proposed in the trailer bill?
4. We currently have a structure for concurrent enforcement under federal law for enforcement of the UDAAP law. How is the concurrent enforcement of the federal law approached today? How will this proposal that would add a layer of state UDAAP law to the current structure change this concurrent enforcement?
5. The trailer bill allows the commissioner to conduct additional activities through an Office of Innovation, what is the scope of those activities and how will they be defined? How does the department envision reporting their findings to the Legislature?
6. There is broad authority under this proposal for DBO to promulgate regulations but is silent on the scope of what will be included in the regulations? How often does DBO anticipate it will use the regulatory process?
7. DBO is also authorized to promulgate regulations on enumerated consumer final laws with overlapping jurisdiction with other state entities, how will DBO address conflicts with other state entities?
8. Can DBO explain why they included industrial banks into this proposal?
9. The proposals include consolidating the state funds. What does this mean for a licensee who pays a fee for a specific purpose? Does this mean the department can use the funds in any way it pleases?

Funding Resources in the 2020-21 Budget.

Staff recommends revisiting the funding resources included in this proposal once the scope of the DFPI's future responsibilities is decided. The trailer bill language will shape the funding resources necessary for DFPI to do its work for the upcoming year.

Staff Recommendation: Informational item only.
