

The Banking Law Journal

Established 1889

An A.S. Pratt™ PUBLICATION

NOVEMBER-DECEMBER 2022

Editor's Note: A Regulatory Wave
Victoria Prussen Spears

How Should Foreign Banks Be Permitted to Engage in Nonbanking Activities within the United States?
Douglas Landy and James Kong

An Antitrust War Against Private Equity?
David H. Evans

FinCEN and U.S. Department of Commerce Issue Joint Alert Highlighting Risks of Export Control Violations for Financial Institutions
Carlton Greene, Jeffrey L. Snyder, Anand Sithian, Chandler S. Leonard, Jeremy Iloulian and Jackie Schaeffer

New York State Department of Financial Services Issues Guidance Addressing USD-Backed Stablecoins; Proposed Responsible Financial Innovation Act Addresses Similar Concerns
David J. Harris, Timothy Spangler, Robert J. Rhatigan, Andrew J. Schaffer and Cindy Wu

A Look Inside California's Commercial Financing Disclosure Regulations
Nancy R. Thomas and Calvin Dennis Funk

The Other Shoe Drops: California DFPI Issues Proposed UDAAP Regulations for Providers of Commercial Financing to Small Businesses and Others
Nancy R. Thomas and Calvin Dennis Funk

Lender Liability Is Alive and Well, as a Recent Bankruptcy Case Shows
Marcus O. Colabianchi and Malcolm M. Bates

Art Finance for High Net Worth Individuals
Tristan Dollie

THE BANKING LAW JOURNAL

VOLUME 139

NUMBER 10

November–December 2022

Editor's Note: A Regulatory Wave Victoria Prussen Spears	551
How Should Foreign Banks Be Permitted to Engage in Nonbanking Activities within the United States? Douglas Landy and James Kong	554
An Antitrust War Against Private Equity? David H. Evans	563
FinCEN and U.S. Department of Commerce Issue Joint Alert Highlighting Risks of Export Control Violations for Financial Institutions Carlton Greene, Jeffrey L. Snyder, Anand Sithian, Chandler S. Leonard, Jeremy Iloulian and Jackie Schaeffer	569
New York State Department of Financial Services Issues Guidance Addressing USD-Backed Stablecoins; Proposed Responsible Financial Innovation Act Addresses Similar Concerns David J. Harris, Timothy Spangler, Robert J. Rhatigan, Andrew J. Schaffer and Cindy Wu	577
A Look Inside California's Commercial Financing Disclosure Regulations Nancy R. Thomas and Calvin Dennis Funk	581
The Other Shoe Drops: California DFPI Issues Proposed UDAAP Regulations for Providers of Commercial Financing to Small Businesses and Others Nancy R. Thomas and Calvin Dennis Funk	587
Lender Liability Is Alive and Well, as a Recent Bankruptcy Case Shows Marcus O. Colabianchi and Malcolm M. Bates	591
Art Finance for High Net Worth Individuals Tristan Dollie	594

QUESTIONS ABOUT THIS PUBLICATION?

For questions about the **Editorial Content** appearing in these volumes or reprint permission, please call:

Matthew T. Burke at (800) 252-9257
Email: matthew.t.burke@lexisnexis.com
Outside the United States and Canada, please call (973) 820-2000

For assistance with replacement pages, shipments, billing or other customer service matters, please call:

Customer Services Department at (800) 833-9844
Outside the United States and Canada, please call (518) 487-3385
Fax Number (800) 828-8341
Customer Service Website <http://www.lexisnexis.com/custserv/>

For information on other Matthew Bender publications, please call
Your account manager or (800) 223-1940
Outside the United States and Canada, please call (937) 247-0293

ISBN: 978-0-7698-7878-2 (print)

ISSN: 0005-5506 (Print)

Cite this publication as:

The Banking Law Journal (LexisNexis A.S. Pratt)

Because the section you are citing may be revised in a later release, you may wish to photocopy or print out the section for convenient future reference.

This publication is designed to provide authoritative information in regard to the subject matter covered. It is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional services. If legal advice or other expert assistance is required, the services of a competent professional should be sought.

LexisNexis and the Knowledge Burst logo are registered trademarks of RELX Inc. Matthew Bender, the Matthew Bender Flame Design, and A.S. Pratt are registered trademarks of Matthew Bender Properties Inc.

Copyright © 2022 Matthew Bender & Company, Inc., a member of LexisNexis. All Rights Reserved. No copyright is claimed by LexisNexis or Matthew Bender & Company, Inc., in the text of statutes, regulations, and excerpts from court opinions quoted within this work. Permission to copy material may be licensed for a fee from the Copyright Clearance Center, 222 Rosewood Drive, Danvers, Mass. 01923, telephone (978) 750-8400.

Editorial Office
230 Park Ave., 7th Floor, New York, NY 10169 (800) 543-6862
www.lexisnexis.com

MATTHEW  BENDER

Editor-in-Chief, Editor & Board of Editors

EDITOR-IN-CHIEF

STEVEN A. MEYEROWITZ

President, Meyerowitz Communications Inc.

EDITOR

VICTORIA PRUSSEN SPEARS

Senior Vice President, Meyerowitz Communications Inc.

BOARD OF EDITORS

BARKLEY CLARK

Partner, Stinson Leonard Street LLP

CARLETON GOSS

Counsel, Hunton Andrews Kurth LLP

MICHAEL J. HELLER

Partner, Rivkin Radler LLP

SATISH M. KINI

Partner, Debevoise & Plimpton LLP

DOUGLAS LANDY

White & Case LLP

PAUL L. LEE

Of Counsel, Debevoise & Plimpton LLP

TIMOTHY D. NAEGELE

Partner, Timothy D. Naegele & Associates

STEPHEN J. NEWMAN

Partner, Stroock & Stroock & Lavan LLP

THE BANKING LAW JOURNAL (ISBN 978-0-76987-878-2) (USPS 003-160) is published ten times a year by Matthew Bender & Company, Inc. Periodicals Postage Paid at Washington, D.C., and at additional mailing offices. Copyright 2022 Reed Elsevier Properties SA., used under license by Matthew Bender & Company, Inc. No part of this journal may be reproduced in any form—by microfilm, xerography, or otherwise—or incorporated into any information retrieval system without the written permission of the copyright owner. For customer support, please contact LexisNexis Matthew Bender, 1275 Broadway, Albany, NY 12204 or e-mail Customer.Support@lexisnexis.com. Direct any editorial inquiries and send any material for publication to Steven A. Meyerowitz, Editor-in-Chief, Meyerowitz Communications Inc., 26910 Grand Central Parkway, #18R, Floral Park, NY 11005, smeyerowitz@meyerowitzcommunications.com, 631.291.5541. Material for publication is welcomed—articles, decisions, or other items of interest to bankers, officers of financial institutions, and their attorneys. This publication is designed to be accurate and authoritative, but neither the publisher nor the authors are rendering legal, accounting, or other professional services in this publication. If legal or other expert advice is desired, retain the services of an appropriate professional. The articles and columns reflect only the present considerations and views of the authors and do not necessarily reflect those of the firms or organizations with which they are affiliated, any of the former or present clients of the authors or their firms or organizations, or the editors or publisher.

POSTMASTER: Send address changes to THE BANKING LAW JOURNAL, LexisNexis Matthew Bender, 230 Park Ave, 7th Floor, New York, NY 10169.

POSTMASTER: Send address changes to THE BANKING LAW JOURNAL, A.S. Pratt & Sons, 805 Fifteenth Street, NW, Third Floor, Washington, DC 20005-2207.

The Other Shoe Drops: California DFPI Issues Proposed UDAAP Regulations for Providers of Commercial Financing to Small Businesses and Others

*By Nancy R. Thomas and Calvin Dennis Funk**

The authors discuss the proposed unfair, deceptive and abusive acts and practices regulations issued by California regulators affecting providers of commercial financing to small businesses and other entities.

Two weeks after the issuance of its commercial financing disclosure regulations, the California Department of Financial Protection and Innovation (“DFPI” or “Department”) issued a notice of proposed action with draft regulations that would (1) expand its unfair, deceptive and abusive acts and practices (“UDAAP”) authority to “Covered Providers” of commercial financing to small businesses and other entities, and (2) impose annual reporting requirements on Covered Providers.

BACKGROUND

Despite its title, the California Consumer Financial Protection Law (“CCFPL”) contains one provision regarding commercial financing. It authorizes the DFPI to define UDAAP in connection with the offering of commercial financing or other financial products and services to small businesses, nonprofits and family farms.¹ It also authorizes the DFPI to promulgate rules requiring data collection and reporting on the provision of commercial financing or other financial products and services.

Pursuant to that authority, the DFPI has issued a Notice of Proposed Action Under the California Consumer Financial Protection Law Regarding Commercial Financial Products and Services, along with the text of Proposed Regulations and its Initial Statement of Reasons.

The Department’s UDAAP authority follows California’s first-of-its-kind commercial financing disclosure law. The California Office of Administrative

* Nancy R. Thomas (nthomas@mofocom), a partner in Morrison & Foerster LLP, is a consumer class action and regulatory enforcement lawyer who represents clients in high-stakes litigation in state and federal courts, as well as in arbitration and administrative proceedings. Calvin Dennis Funk (cfunk@mofocom) is an associate in the firm’s Financial Services Group who advises clients on state and federal regulatory regimes that impact credit, payments, banking and fintech businesses.

¹ Cal. Fin. Code § 90009(e).

Law has approved the DFPI's final regulations implementing the commercial financing disclosure law, and the regulations will take effect on December 9, 2022 (the "Commercial Financing Disclosure Regulations").

SCOPE

The Proposed Regulations would apply to providers of commercial financing or other financial products and services to small businesses, nonprofits and family farms.

Covered Providers under the CCFPL and the Proposed Regulations are providers of: (a) commercial financing, as defined in the commercial financing disclosure law; or (b) other financial products or services to Covered Consumers. It appears that this definition would cover providers and financiers, but does not appear to cover brokers as those terms are defined in the Commercial Financing Disclosure Regulations.

In one of a few odd definitions, the DFPI would define "financial products or services" to have the same meaning as that term in the CCFPL, except that "consumer" in the Proposed Regulations would mean the opposite of "consumer": specifically, the term "consumer" would include corporations, partnerships and all other organizations or legal or commercial entities.

Covered Consumers similarly would include non-consumers: small businesses, nonprofits and family farms whose activities are "principally directed or managed from California."

Small Business would have the same meaning as in California Code of Civil Procedure Section 1028.5(c). This provision concerns small businesses that can recover attorney's fees in litigation between small businesses and state regulatory agencies. It defines small business as a business that is independently owned and operated, not dominant in its field and below specified maximum thresholds in annual gross receipts or other criteria in various sectors such as general construction, retail trade and transportation.

The Proposed Regulations also would define nonprofits and family farms.

UDAAP DEFINITIONS

The definitions of unfair and deceptive would have two parts. Part one is lifted verbatim from the UDAAP section of the Consumer Financial Protection Bureau's exam manual. The second part is a reference to any practice that is unfair or deceptive under the California Unfair Competition Law, Business & Professions Code Section 17200.

The definition of abusive is lifted verbatim from the CCFPL, which the California legislature lifted directly from Dodd-Frank Act Title X.²

UDAAP ENFORCEMENT

Although the CCFPL only authorizes the DFPI to define UDAAP for commercial financing to small businesses and other recipients and to require reporting, the Proposed Regulations would specify that it is “unlawful for a Covered Provider to engage” in UDAAP.

The Proposed Regulations also attempt to add remedies for enforcement proceedings beyond those authorized by the CCFPL. The CCFPL provides that the Department may conduct hearings and adjudication proceedings with respect to any “person” to ensure or enforce compliance with any rule the Department imposes under the law.³ The term “person” is defined broadly such that it includes Covered Providers as defined in the Proposed Regulations.⁴ The CCFPL provides that the DFPI may assess penalties and issue a desist and refrain order. It authorizes “ancillary relief”—meaning contract rescission, refunds, restitution, disgorgement, damages, etc.—only for a violation “with respect to consumer financial products,” as that term is defined in the CCFPL.⁵

Despite the specified limitations in the CCFPL, the Department purports to authorize itself to seek ancillary relief for UDAAP violations under the Proposed Regulations.

REPORTING REQUIREMENTS

The Proposed Regulations also would require Covered Providers to file reports annually identifying:

- Contact information;
- Total number and dollar amount of transactions with Covered Consumers;
- Number of transactions with Covered Consumers by amount financed and type of commercial financing or other financial product or service; and
- Minimum, maximum, average and median total cost of financing by

² 12 U.S.C. § 5531(d).

³ Cal Fin. Code § 90015(a).

⁴ Cal Fin. Code § 90005(m).

⁵ Cal Fin. Code §§ 90015(e), 90012(b).

type of transaction, calculated in accordance with the Commercial Financing Disclosure Regulations.

The Proposed Regulations would clarify that transactions reported by California Financing Law (“CFL”) licensees under the CFL should not report the same information to the Department under the Proposed Regulations.

INITIAL TAKEAWAYS

Throughout the Proposed Regulations, the DFPI conflates consumer and commercial financing. In the Initial Statement of Reasons, the DFPI acknowledges that the legislature was focused on creating “[r]obust consumer protections” and asserts the anticipated benefits of the Proposed Regulations include “an increase in consumer welfare.” Despite the DFPI’s “Covered Consumer” terminology, though, the Proposed Regulations concern financing to businesses, nonprofits and family farms, not consumers.

The DFPI copies definitions of UDAAP verbatim from Dodd-Frank Title X, which also concerns consumer financial products and services. The DFPI tries to connect lending to consumers with lending to organizations by claiming these organizations are “managed and operated by individuals and consumers of financial products and services just like individual consumers.” This assertion is not backed up by any analysis or research regarding the thresholds specified in the definition of small businesses in a statutory provision unrelated to commercial lending. It also skips over the corporate form entirely as well as the legal and practical distinctions between business organizations and the individuals who own those organizations.

In addition, the DFPI does not explain why UDAAP definitions that apply to consumer transactions should similarly apply to commercial financing transactions. The DFPI’s broad, general approach reflects an assumption that we know it when we see it. Covered Providers would be left attempting to read the tea leaves, trying to understand the UDAAP framework based on DFPI consent orders.

Covered Providers should consider participating in the rulemaking process, particularly with respect to definitions of covered financing recipients such as small businesses that are pulled from statutes unrelated to commercial financing or were created by the DFPI for the Proposed Regulations.