August 29, 2022

Department of Financial Protection and Innovation
Legal Division
Attn: Sandra Navarro, Legal Assistant
2101 Arena Blvd.
Sacramento, CA 95834

Re: PRO 05-21 — Proposed Regulations Under the Debt Collection Licensing Act

Dear Ms. Navarro:

On behalf of the American Financial Services Association ("AFSA") and California Financial Services Association ("CFSA"),[1] thank you for the opportunity to provide comments on the Department's July 15 draft text for the Proposed Second Rulemaking Under the Debt Collection Licensing Act (PRO 05-21). AFSA and CFSA represent financial institutions of all sizes across many of the industries DFPI oversees, including institutions that may be required to apply for licensure under the Debt Collection Licensing Act (DCLA) as well as institutions that hold other license types from DFPI. We believe clear rules benefit consumers and financial institutions alike, and we appreciate the Department's consideration of our previous comments related to the DCLA. We also appreciate the steps DFPI has taken to clarify definitions and narrow the scope of the rules.

§ 1850. Definitions.

(i) "Employee"

We appreciate DFPI exempting employees from the licensing requirements in Section 1850.1(a), similar to the federal Fair Debt Collection Practices Act's (FDCPA) exemption for employees. However, we believe additional clarification is necessary to protect the ability of debt collectors to utilize the services of non-W2 workers, including 1099 workers, temporary help from a staffing agency, or a collection agency employee, who works for a creditor to collect in the creditor's name at the creditor's office under the creditor's supervision. Such workers would be covered by the *de facto* employee exemption of the FDCPA, but would not meet the W2 employee definition of the proposed rules. Accordingly, we respectfully request the proposed definition be updated to include *de facto* employees.

[1] Founded in 1916, the American Financial Services Association (AFSA), based in Washington, D.C., is the primary trade association for the consumer credit industry, protecting access to credit and consumer choice. AFSA members provide consumers with many kinds of credit, including direct and indirect vehicle financing, traditional installment loans, mortgages, payment cards, and retail sales finance. AFSA members do not provide payday or vehicle title loans.

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(j) "Engage in the business of debt collection"

We request clarity that any debt collection performed by creditors in connection with existing customer obligations is not for the profit and gain from engaging in debt collection. Creditors already have a mutually beneficial contract with the consumer for the profit they intend to make. Requesting their customer to continue to follow the contract and pay by collecting on that contract is not engaging in debt collection for profit and should not be treated as such. When the debt is in default, creditors risk losing their profit, and consumers risk losing their benefits under their contracts. This is a crucial difference between third-party debt collectors and creditors. Third-party debt collectors are performing the collection function for profit and gain solely based on their efforts to collect, whereas the creditor is just attempting to service an existing contract the contract with no extra profit and gain beyond the existing obligation. Accordingly, we recommend the following revision to §1850 (j) to focus the definition on entities whose businesses are solely debt collection from consumers rather than creditors collecting on existing obligations:

> (j) "Engage in the business of debt collection": A person engages in the business of debt collection and is required to be licensed pursuant to section 100001, subdivision (a) of the Financial Code if the person (A) engages in debt collection for a profit or gain that is earned solely from the act of collecting past due amounts, and (B) the activity is of a regular, frequent, or continuous nature. Advertising or otherwise offering the service of debt collection for remuneration constitutes engaging in the business of debt collection.

Additionally, we remain concerned that neither the DFPI nor the definition in the proposed regulations gives any guidance for attorneys or law firms retained by AFSA and CFSA members to defend them in litigation initiated by consumers who are, themselves, represented by counsel. Because of the lack of guidance from the DFPI in the proposed regulations or otherwise, AFSA and CFSA members who retain defense counsel to defend litigation initiated by consumers must also retain a separate set of DCLA-licensed attorneys to prosecute compulsory counter-claims on the debt or affirmative defenses of "offset" in the context of defending litigation. This dual-licensing regime prohibiting defense counsel from prosecuting counter-claims on the debt or affirmative defenses of offset conflicts with AFSA's and CFSA's members' right to select counsel of their choice, as well as with the California's State Bar Act and the federal Rules of Civil Procedure and Local Rules that permit AFSA's and CFSA's members' defense counsel to represent AFSA and CFSA members in any Court in which they are admitted. Moreover, requiring retention of two sets of lawyers is confusing to consumers, causes significant undue expense to AFSA's and CFSA's members, and multiplies the potential exposure for creditors' attorneys' fees to consumers who do not prevail in litigation. Deeming defense counsel's activities in this regard is unnecessary, since represented consumers are protected by their own counsel in the litigation process, by the Rules of Professional Conduct, and by judicial supervision of the litigation.

We request that the rules provide clarity on this issue such that the DFPI follow 9th Circuit precedent and state with respect to section 1850(j)(B) that communications or activity between counsel is not licensable activity is exempt from the calculus of determining whether activity is regular, frequent, or continuous in nature. E.g. Guerrero v. RJM Acquisitions LLC, 499 F.3d

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926, 935-939 (9th Cir. 2007) ("While no purpose of the Act is furthered by the unwarranted extension of its prohibitions to communications targeted exclusively at a debtor's attorney, the facts of this case illustrate well how a contrary rule would actively frustrate some of these objectives [of the FDCPA]").

§ 1850.1 Scope of Licensing requirement.

Subsidiaries and Affiliates

We urge the DFPI to reconsider Section 1850.1(b), which given the extensive requirements under state and federal law with which existing licensees and other federally chartered financial institutions already comply, additional requirements under the DCLA would be duplicative and unnecessarily create a significant compliance burden with limited consumer benefit and will only serve to distract the DFPI from the main target of the law and licensing requirements—California debt collectors with no existing state or federal oversight.

A bank's structure should not be the factor that ultimately determines whether its activities subject it to state debt collector licensing. Under the rule as written, a bank insured by the Federal Deposit Insurance Corporation (FDIC) does not need to be licensed as a debt collector. But, if the bank has certain servicing activities performed by an affiliate or subsidiary, it must be licensed as a debt collector, even though these affiliates and subsidiaries are also regulated by the FDIC, Office of the Comptroller of the Currency (OCC), Consumer Financial Protection Bureau (CFPB), and others, just like the parent bank, and are subject to federal examinations and oversight. DFPI oversight would be duplicative.

The OCC, for example, supervises and examines national banks by conducting on-site reviews, providing ongoing supervision of the bank's operations, and regularly meets with bank management and board of directors.[2] The OCC also takes enforcement action against banks that engage in risky practices or do not comply with their rules and regulations.

Unlike other debt collectors, national banks have examiners that are assigned and solely dedicated to the examination of their operations, and even may reside on site in pre-pandemic environments. A credentialed national bank examiner has the following responsibilities:

- maintains an up-to-date understanding of the condition and risk profile of the bank;
- identifies risks and responds in an appropriate and timely manner;
- considers the risks posed by significant activities or affiliates, including affiliates or lines of business subject to the primary supervision of another regulator, in determining the bank's ratings and risk assessment;
- maintains responsibility for ongoing supervision of the bank and oversees the execution of examination plans;
- updates the OCC's supervisory information systems to reflect the bank's current risk profile and condition;

[2] Comptroller's Handbook Examination Process, Bank Supervision Process, Version 1.0, June 2018 https://www.occ.gov/publications-and-resources/publications/comptrollers-handbook/files/bank-supervision-process/pub-ch-bank-supervision-process.pdf

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- maintains ongoing and effective communication with bank management and the board;
- keeps the supervisory office informed about the status of each assigned bank;
- establishes and maintains points of contact with domestic and foreign banking supervisors and other regulatory agencies, as appropriate;
- implements OCC and supervisory office directives;
- takes actions to require banks to address deficiencies, or recommends such actions to the supervisory office; and
- follows up on bank management's actions to address deficiencies and outstanding enforcement actions.

DFPI's proposed rule would also require the sharing of significant personal information of licensee principal officers and others, including their social security numbers and fingerprints. National banks already follow an in-depth application process to be chartered as an OCC-supervised bank, that includes character requirements as well as comprehensive background checks of the bank's organizers, senior executive officers, senior officers, directors, principal bank shareholders, and general managers of federal branches or agencies.[3] In this application, the OCC must consider experience, competence, and integrity, and may also consider a person's character, financial ability, or willingness to direct or lead a bank's business in a safe, sound, and legal manner. The OCC also closely examines the backgrounds of filers whose previous experience contributed to a failed or "troubled" financial institution or when other facts may raise questions about competence, character, or personal or fiduciary integrity. These background checks include information from:

- Credit Bureaus;
- Federal Bureau of Investigation;
- Federal and state regulators of banks and other entities;
- IRS;
- Publicly-available online resources, including the "Interagency Biographical and Financial Report";
- FinCEN; and
- Enforcement Action Report System, an OCC database of historical criminal referral information.

The OCC may also perform additional background checks when deemed appropriate, including making a request for background information from:

- U.S. Commodity Futures Trading Commission;
- State and local law enforcement agencies;
- Federal Trade Commission;
- Local courts;
- National Association of Securities Dealers; and
- U.S. Securities and Exchange Commission.

[3] Comptroller's Licensing Manual: Background Investigations, https://www.occ.gov/publications-and-resources/publications/comptrollers-licensing-manual/files/background-investigations-licensing-manual.pdf

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Most investigations also include fingerprint checks and "IRS Tax Check Waiver" forms. Indeed, changes in directors and senior officers of a national bank or federal savings association require notice that includes fingerprinting of any individual that hasn't been fingerprinted within the prior three years.[4] For all of these reasons, we respectfully urge DFPI to reconsider Section 1850.1(b), and instead apply the depository institution exemption referenced in Section 10001(b)(1) of the DCLA to subsidiaries and affiliates of depository institutions.

Original Creditors

We applaud the DFPI refining its licensing requirement to more closely follow the federal FDCPA by recognizing that creditors are not engaged in the business of debt collection simply to recover a profit by collecting debts. However, as drafted, the exceptions cover those lenders that directly contracted with the customer but may not cover finance companies that provided the financing to the customer through the seller of the goods or services (e.g. a retail installment sales contract financing the purchase of a vehicle). Sellers of goods may not be able to provide the financing directly to consumers, so they rely on finance companies to provide the financing, and then the obligation is immediately assigned to the finance company. This indirect lending is a common form of financing, particularly in vehicle sales where the auto dealer arranges such financing for a consumer.

As the licensing requirements are drafted, it's not clear whether finance companies that provide indirect financing and take assignment of a contract must get licensed for performing the same collections a depository institution or other originating creditor does for a direct loan. With indirect financing, whether a depository institution or non-depository finance company that took assignment of the contract upon it being signed is indistinguishable to a consumer. The entity that was assigned the new contract is the creditor that is going to service the account, take the consumers' payments, and bring the contract to conclusion. With vehicle finance companies, for instance, this will mean helping the customer get to the end of the contract so the vehicle title can be turned over to the customer. Indirect financing is no different than direct loans over the course of servicing a contract, and the exception for creditors should reflect both. Additionally, the rule should also reflect situations where a creditor has purchased debt not in default at the time of purchase, then sold the debt after default, but continues to service in its own name. Accordingly, we request 1850.1(c) be amended to read, in part:

> (c) ~~Original~~ Creditor: A ~~creditor~~ person seeking, in its own name, repayment of consumer debt arising from credit the creditor extended, financed under the original contract, or previously owned, and who is not engaged in the business of debt collection for purposes of licensure under the Debt Collection Licensing Act, unless it meets one or more of the following criteria:

We also have concerns about parts (c)(1)-(3). First, we recommend changing the "within the last 12 months" language of each part instead to reflect the previous calendar year. As drafted, the timing requirement could necessitate a calculation at least monthly. If the licensing requirement is then triggered, the person must be licensed. However, it takes time to obtain a license and

[4] 12 CFR § 5.51

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persons do not have control of when a license will be granted. Further, Cal. Fin. Code 100022 requires a licensee to surrender their license if the licensee ceases to engage in debt collection. As annual profits, receivables and repossessions fluctuate, a person would be obtaining and surrendering licenses frequently; and likely submitting license applications and withdrawing if such figures, go above or below the threshold while the application is pending.

Additionally, the terms used in parts (c)(1)-(3) are vague and require definitions or clarity. For (c)(1) it isn't clear what "whether contracted for or received" means. For (c)(2), what does "inventory" mean? Is this referring to the debt collector's portfolio of debt? If so, is it limited to the portfolio of debt secured by a motor vehicle? For (c)(3), it is not clear whether the gross amount of accounts receivables is limited to just California debtor accounts as defined in the Act. We request that DFPI clarify each of these sections.

Servicers

We appreciate DFPI's inclusion of a servicer exception, recognizing that servicers are the creditors under many contracts and often the only creditor with whom a consumer has a direct relationship. Consumer obligations being managed by servicers is very common in financial markets, and a clear exception would be consistent with the federal FDCPA. In most cases a servicer obtains an account immediately after it is originated and works with the consumer throughout the contract. The account is not in default when acquired and the servicer will only need to exercise remedies available under the contract if the consumer does not pay. As with creditors, the servicers are not in the business to make a profit on debt collection. They manage the contract through completion, including communicating with the consumer to address any concerns and helping the consumer to stay current so the consumer can comply with the contract.

Accordingly, we recommend that the DFPI adopt a requirement similar to the FDCPA definition of the servicer exception: if the servicer receives the account before it is in default, the servicer is not considered a debt collector.

> (d)A person solely servicing debts ~~not in default~~ on behalf of an original creditor, as described in subdivision (c), is not engaged in the business of debt collection for the purposes of licensure under the Debt Collection Licensing Act if the debt was not in default at the time it was obtained from the creditor and the person's principal purpose is not the business of debt collection. For purposes of this section, "default" means more than 90 days past due~~, unless the contract governing the transaction or another law provides otherwise~~.

§ 1850.2 Consumer credit transactions.

We respectfully request that DFPI add consumer vehicle leases to the exclusions under Section 1850.2(a) of types of debt that are not "consumer debt" within the meaning of section 100002, subdivision (f) of the Financial Code. The DFPI's jurisdiction is limited to regulation of "consumer credit transactions." (Fin. Code section 100002(e)). California Courts of Appeal have held that a consumer vehicle lease is not a "consumer credit contract." *LaChapelle v. Toyota Motor Credit Corp.,* 102 Cal. App. 4th 977, 987 (2002) ("The lease agreement therefore does

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meet the definition of a consumer credit contract, and that the FTC Holder Rule, therefore, does not apply to it."); *Bescos v. Bank of Am.,* 105 Cal. App. 4th 378, 393 (2003) ("Furthermore, the lease agreement does not qualify as a "consumer credit contract."). For the same reason that the DFPI's proposed regulation concludes, as do a host of decisions, that residential rent is not a "consumer credit transaction" and that the Courts of Appeal have concluded that vehicle leases are not "consumer credit transactions," the DFPI should add consumer vehicle leases to the types of debt that do not constitute "consumer credit transactions" (i.e. consumer debt") within the meaning of Fin. Code section 10000(e)-(f) and section 1850.2 of the proposed regulations.

§1850.71 Document Retention.

As drafted, the records required to be maintained in 1850.71(a) would be held, seemingly, in perpetuity and create a significant compliance burden for licensees, particularly with regard to the call recordings in (a)(6). We recommend that any requirement to retain records be limited to three years, consistent with existing California Financing Law, which only requires records be retained "for at least three years after making the final entry on any loan recorded therein." See Cal. Fin. Code 22157. Similar to part (a), we recommend that the seven-year retention requirement in part (d) also be limited to three years.

Part (c)(6) would require retention of complaint records, responses, and documentation establishing compliance with the regulations adopted pursuant to Division 24 of the Financial Code. We recommend amending this section to reflect that certain DCLA licensees may be exempt those regulations. The differences between the DCLA and the California Consumer Financial Protection Law (CCFPL) creates the possibility of a person being licensed under the DCLA but exempt from the CCFPL. Without clarity, such a person could then be required to comply with the CCFPL complaint requirements. For persons that are licensed under DCLA and not exempt from CCFPL, they already have to comply with the complaint requirements under CCFPL without this language. Accordingly, we recommend (c)(6) be amended to read:

> (6) Complaint records, responses, and documentation establishing compliance with the regulations adopted pursuant to Division 24 of the Financial Code, unless exempt from such requirements.

Thank you in advance for your consideration of our comments. If you have any questions or would like to discuss this further, please do not hesitate to contact us.

Sincerely,

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