

# Client Alert

February 2020

## A Spur to Innovation or an Impending Crackdown on Lenders and Fintech Companies? California and Other States Move to Create Mini-CFPBs to Fill a Perceived Regulatory Void

### A. Introduction and Summary of Act

On January 31, 2020, California Governor Gavin Newsom released a proposed budget and, along with it, a draft of the California Consumer Financial Protection Act (the Act) that calls for the transformation of the California Department of Business Oversight (DBO) into an agency tasked with regulating 51 state consumer finance laws and 21 federal consumer laws under one roof. The law—which was drafted with significant input from the former CFPB head Richard Cordray—would create a “Department of Financial Protection and Innovation” (DFPI). California is one of several states leading the charge in creating a state “mini-CFPB” in response to the federal government’s rollback of regulations under the CFPB. A handful of other states—New Jersey, New York, and Pennsylvania, among others— have done the same.

According to the Act, consumers and businesses are “left vulnerable to unfair competition from providers that are willing to cheat to gain an advantage by violating the law.” Cal. Fin. Code § 90000(a)(1) [proposed]. To allay concerns, the Act promises to “[s]pur — not stifle — innovation in financial services” and “[p]rotect consumers from predatory businesses, without imposing undue burdens on honest and fair operations” by clarifying regulatory exceptions for emerging products and services, something that could be welcomed by the industry. Governor Newsom has earmarked more than \$40 million for the agency.

Entities that offer consumer financial services to California residents—from traditional banks to installment lenders and fintech companies—are wondering what this will mean for them should the legislature approve the budget and Act by the June 15 deadline. This article seeks to distill the Act so that companies can plan accordingly for California and for actions by other state mini-CFPBs.

### B. The Act’s Scope: Regulation of “Enumerated Consumer Financial Laws” and Certain “Covered Persons.”

#### 1. Which consumer financial laws will be subject to the DFPI’s authority?

The Act provides that the DFPI “shall regulate the offering and provision of *consumer financial products or services* under California consumer financial laws *and* shall exercise oversight and enforcement authority under California consumer financial laws.” *Id.* § 90003(a) [proposed]. The Act lists 51 state and 21 federal consumer laws as the “enumerated consumer financial laws” subject to regulatory oversight. Identified laws include everything from the federal Truth-in-Lending Act, Consumer Leasing Act, Equal Credit Opportunity Act and Electronic Funds Transfer Act, to the California Financing Law and Unruh Act. *Id.* § 90002(k) [proposed]. While the list of laws comes as no surprise to some, entities such as consumer lenders and fintech companies may be surprised and possibly unnerved by the DFPI’s regulatory power and authority.

The powers of the DFPI will include the ability to inspect, examine and conduct private and public investigations to determine whether a person has violated the Act. Penalties for violating the Act are

steep: a maximum civil penalty of \$50,000 for the first violation and \$100,000 for each subsequent violation. Cal. Gov. Code § 12989.3(f)(3) [proposed]. The DFPI will also have “the authority to adopt, promulgate, amend, *and rescind* regulations interpreting and implementing the enumerated California financial laws and to prevent evasions thereof.” Cal. Fin Code § 90006(a) [proposed]. Importantly, the Act gives UDAAP police powers to the DFPI, stating that the DFPI “may prescribe rules applicable to a covered person or service provider identifying as unlawful, unfair, deceptive, or abusive acts or practices.” *Id.* at § 90006(i)(3) [proposed].

## 2. Who qualifies as a “covered person” and what is the significance?

Apart from the list of “enumerated consumer financial laws” to be subject to DFPI authority, any “covered person” will also be subject to regulatory oversight. A “covered person” is defined as “[a]ny person that engages in offering or providing a *consumer financial product or service*.” *Id.* at § 90002(f) [proposed]. Consumer lenders and banks that “extend[] credit and servic[e] loans, including acquiring, purchasing, selling, brokering, or other extensions of credit” by definition, offer or provide a consumer financial product or service. *Id.* at § 90002(l)(1) [proposed]. Further, “[e]ngaging in deposit-taking activities, transmitting or exchanging funds...” and “[p]roviding check cashing, check collection, or check guaranty services” also constitute consumer financial product or service offerings. *Id.* at § 90002(l)(4)(6) [proposed]. Thus, entities engaging in the aforementioned practices qualify as a “covered person” under the Act. Notably, consumer lenders and other consumer financial entities who qualify as a covered person will be subject to registration and reporting requirements, among other obligations. *See, generally, Id.* at § 90003-90006 [proposed]. The DFPI also has the authority to regulate and enforce UDAAP violations. *Id.* at § 90006(i).

That said, certain entities engaged in operations that merely cross into areas subject to enumerated consumer financial laws may not qualify as “covered persons” under the Act. For example, RTO and consumer leasing lessors may not qualify as covered persons because they do not offer a “financial product or service” as defined by the Act. For example, only leases that are “on a nonoperating basis” and with an initial term of “at least 90 days” are expressly covered. *Id.* at § 90002(l) [proposed].

## C. FinTech and a Promise to Foster Innovation

The Act also promises to spur innovation. The DBO’s website vows that the Act will clarify regulatory expectations for financial products and services and “[c]reate an Office of Financial Technology Innovation, based in San Francisco....” This office will study new trends and engage with California companies developing financial products and services. It remains to be seen just how committed this new office will be to fintech innovation, as it comes on the heels of California’s opposition to the CFPB’s own “fintech sandbox” that allows firms to develop untested fintech products and services without fear of liability.

## D. Other States With “Mini-CFPBs” Following the Perceived Roll-Back of the CFPB.

California is not alone. Several other states have responded to the CFPB’s perceived inaction and funding issues by creating their own “mini-CFPBs.” For example, Pennsylvania created its Consumer Financial Protection Unit in 2017. Meanwhile, New York launched the New York Department of Financial Services in 2019 and New Jersey’s Office of the Attorney General recently proclaimed that the state’s Division of Consumer Affairs serves as a “state-level CFPB.” California’s creation of the DFPI is not unprecedented, but given the scope of the Act, the role of Richard Cordray in drafting, and California’s historically assertive role in regulation, banks and other finance companies can expect a more active regulatory environment in California once the Act becomes law.

## E. Conclusion

In summary, should the Act become law as expected, it will result in a new “mini-CFPB” in the most populous state in the country. Traditional banks, installment lenders and entrepreneurial fintech

companies, among others, should be aware of the Act's potential implications. Questions to be posed include:

- Are the entity's activities subject to any of the Act's "enumerated consumer financial laws"?
- Does the entity qualify as a "covered person" under the Act?
- Does the entity offer "consumer financial products or services" as defined by the Act?
- What will the entity's registration and reporting obligations be, if any?
- What other implications arise from the Act?

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