

**State of California
Office of Administrative Law**

In re:
**Department of Financial Protection and
Innovation**

Regulatory Action:
Title 10, California Code of Regulations

Adopt sections: 1000, 1001, 1002,
1003, 1004, 1010,
1011, 1012, 1020,
1021, 1022, 1023,
1024, 1025, 1026,
1030, 1031, 1032,
1033, 1034, 1040,
1041, 1042, 1043,
1044, 1045, 1048,
1050, 1051, 1052,
1053, 1430.1, 1461,
1462.5, 1465, 1466,
1467, 2030.5, 2044.1

Amend sections:
Repeal sections:

**DECISION OF DISAPPROVAL OF
REGULATORY ACTION**

Government Code Section 11349.3

OAL Matter Number: 2024-0314-01S

OAL Matter Type: Regular (S)

SUMMARY OF REGULATORY ACTION

In this action by the Department of Financial Protection and Innovation (Department), the Department proposed to establish registration fees and registration requirements for persons engaged in the business of offering to provide or providing consumer financial products or services, such as debt settlement, student debt relief, education financing, and income-based advances. The regulations also provide exemptions to the registration requirements. The adoptions further set forth annual reporting requirements, procedures for the revocation of a registration, and procedures for the surrender of a registration.

On March 14, 2024, the Department submitted the above-referenced rulemaking action to the Office of Administrative Law (OAL) for review. On April 26, 2024, OAL notified the Department that OAL disapproved the proposed action pursuant to the Administrative Procedure Act (APA). This Decision of Disapproval of Regulatory Action explains the reasons for OAL's action.

DECISION

OAL disapproved the above-referenced regulatory action because the proposed regulatory changes failed to comply with the clarity standard of Government Code section 11349.1, subdivision (a)(3) and with a required APA procedure.

DISCUSSION

The Department's action must satisfy requirements established by the part of the APA that governs rulemaking by a state agency. Any regulation adopted, amended, or repealed by a state agency to implement, interpret, or make specific the law enforced or administered by it, or to govern its procedure, is subject to the APA unless a statute expressly exempts the regulation from APA coverage. (Gov. Code, sec. 11346.) No exemption applies to this regulatory action.

Before any regulation subject to the APA may become effective, the regulation is reviewed by OAL for compliance with the procedural requirements of the APA and for compliance with the standards for administrative regulations in Government Code section 11349.1. Generally, to satisfy the standards a regulation must be legally valid, supported by an adequate record, and easy to understand. In this review, OAL is limited to the rulemaking record and may not substitute its judgment for that of the rulemaking agency regarding the substantive content of the regulation. This review is an independent check on the exercise of rulemaking powers by executive branch agencies intended to improve the quality of regulations that implement, interpret, and make specific statutory law, and to ensure that the public is provided with a meaningful opportunity to comment on regulations before they become effective.

1. CLARITY STANDARD

In adopting the APA, the Legislature found the language of many regulations to be unclear and confusing to persons who must comply with the regulations. (Gov. Code, sec. 11340, subd. (b).) Government Code section 11349.1, subdivision (a)(3), requires that OAL review all regulations for compliance with the clarity standard. Government Code section 11349, subdivision (c), defines "clarity" to mean "written or displayed so that the meaning of the regulations will be easily understood by those persons directly affected by them."

The "clarity" standard is further defined in section 16, title 1, of the California Code of Regulations (CCR), OAL's regulation on "clarity," which provides:

In examining a regulation for compliance with the "clarity" requirement of Government Code section 11349.1, OAL shall apply the following standards and presumptions:

(a) A regulation shall be presumed not to comply with the "clarity" standard if any of the following conditions exists:

- (1) the regulation can, on its face, be reasonably and logically interpreted to have more than one meaning; or
 - (2) the language of the regulation conflicts with the agency's description of the effect of the regulation; or
 - (3) the regulation uses terms which do not have meanings generally familiar to those "directly affected" by the regulation, and those terms are defined neither in the regulation nor in the governing statute; or
 - (4) [...]
 - (5) [...]
 - (6) [...]
- (b) Persons shall be presumed to be "directly affected" if they:
- (1) are legally required to comply with the regulation; or
 - (2) are legally required to enforce the regulation; or
 - (3) derive from the enforcement of the regulation a benefit that is not common to the public in general; or
 - (4) incur from the enforcement of the regulation a detriment that is not common to the public in general.

The following provisions in the Department's proposed regulations do not satisfy the clarity standard.

1.1 Proposed Section 1021, subdivision (a) – Instructions of NMLS

The proposed regulations incorporate two forms by reference: Form MU1 (for companies) and Form MU2 (for individuals). The applicants for registration are required to register with the Commissioner by filing these forms electronically and transmitting them through the Nationwide Multistate Licensing Systems & Registry (NMLS). Proposed section 1021, subdivision (a), explains how to fill out the forms but the instructions are unclear. It states:

1021. Registration Application

The procedures set forth in this section are applicable to a person who is required to be registered pursuant to this subchapter. If an applicant is offering or providing more than one subject product, separate registration is required for each subject product. The application for registration shall be filed as follows:

(a) INITIAL APPLICATION: ***The applicant shall complete and file Form MU1 in accordance with the instructions of NMLS and this subchapter*** for transmission to the Commissioner. Unless otherwise specified below, an applicant shall complete all sections of Form MU1. All exhibits and supporting documents related to the application or amendment ***required by NMLS*** or identified in this section shall be filed with NMLS (***unless otherwise specified***), in accordance with the ***instructions of NMLS*** and this subchapter for transmission to the Commissioner. An applicant shall provide the following information, exhibits, and documentation in the manner provided below....

(13)(A)...

(B) For each individual, the applicant shall complete Form MU2 in accordance with the **instructions of NMLS** and this subchapter for transmission to the Commissioner...

[Emphasis added.]

The forms include brief descriptions on how to fill out each part of the form. However, it is unclear whether the phrase “in accordance with the instructions of NMLS” includes only the brief descriptions on the forms or whether it also refers to other instructions included in other documents. Thus, proposed section 1021, subdivision (a), is unclear because it can be reasonably and logically interpreted to have more than one meaning. (Cal. Code Regs., tit. 1, sec. 16, subd. (a)(1).)

Moreover, in requiring the applicant to complete and file Form MU1 in accordance with both the “instructions of NMLS” and the regulations in this subchapter, the Department must ensure that all instructions and descriptions on how to fill out the forms are consistent with each other.

1.2 Proposed Section 1021 – Date an Application is Deemed Abandoned

Proposed section 1021 is unclear as to when an application is deemed abandoned. It states:

1021...

(a)...

(c) COMPLETION OF FILING and ISSUANCE OF REGISTRATION:

An application for registration is complete when all required fees and all information required by this section are received by the Commissioner. The filing of Forms MU1 and MU2(s) with NMLS does not constitute automatic approval of a registration. Within thirty (30) days of an applicant filing Forms MU1 and MU2(s) and other information, and paying all required fees, the Commission shall either:

(1) Inform the applicant in writing that the registration application has been approved; or

(2) Inform the applicant in writing that the applicant has not fully completed part(s) of the application, identify the part(s) that has not been fully completed, and state that the application will be considered abandoned **if the applicant does not respond within sixty (60) days**.

(d) INCOMPLETE INFORMATION: If an applicant submits additional information **after receiving** a notice of deficiency... the Commissioner shall, within thirty (30) days:

(1) Inform the applicant in writing that the registration application has been approved; or

(2) Inform the applicant in writing that the applicant has not fully completed part(s) of the application, identify the part(s) that has not

been fully completed, and state that ***the application will be considered abandoned if the applicant does not respond within sixty (60) days.***

(e) ABANDONMENT FOR FAILURE TO RESPOND: If the applicant fails to respond to the notice of deficiency provided under paragraph (2) of subdivision (c) or paragraph (2) of subdivision (d) of this section within sixty (60) days, the Commissioner shall deem the application for registration abandoned.

(f) ABANDONMENT FOR INCOMPLETE APPLICATION: If the applicant fails to submit a complete application ***within 60 days after the third notice of deficiency*** under paragraph (2) of subdivision (c) or paragraph (2) of subdivision (d) of this section, the Commissioner shall deem the application for registration abandoned....

[Emphasis added.]

First, it is unclear when the computation of the sixty days begins. It could be reasonably and logically interpreted that the sixty days begins after the applicant receives the notice of deficiency or when the Department sends the notice of deficiency to the applicant. (Cal. Code Regs., tit. 1, sec. 16, subd. (a)(1).)

Second, it is unclear how many notices of deficiencies the applicant must be issued before the Department deems the application abandoned. As written, subdivision (f) could mean three notices of deficiencies issued pursuant to subdivision (c)(2) or three notices of deficiencies pursuant to subdivision (d)(2).

In addition, the Initial Statement of Reasons (ISOR) explains that “DFPI shall deem an application abandoned when an applicant does not respond to ***any*** notice of deficiency within 60 days.” (Emphasis added.) According to the explanation in the ISOR, if an applicant fails to respond to one notice of deficiency, the application shall be deemed abandoned.

Thus, section 1021 is unclear because it can be reasonably and logically interpreted to have more than one meaning. (Cal. Code Regs., tit. 1, sec. 16, subd. (a)(1).) Additionally, section 1021 is unclear because the language of the regulation conflicts with the agency’s description of the effect of the regulation (Cal. Code Regs., tit. 1, sec. 16, subd. (a)(2).)

1.3 Proposed Section 1041, Subdivision (c) – Revocation of Registration

Proposed section 1041, subdivision (c), allows the Commissioner to revoke a registration when a registrant fails to comply with annual reporting requirements. It states:

1041. Annual Reporting – General
(a)...

(c) **The Commissioner may by order summarily revoke** the registration of any registrant if the registrant fails to file the report required by this section **within ten (10) days after notice** by the Commissioner that the report is due and not filed. If, after an order is issued, a request for hearing is filed in writing within thirty (30) days of the date of the order and the hearing is not held within sixty (60) days of the date of the order, the order is deemed rescinded as of its effective date. The proceedings under this section shall be conducted in accordance with chapter 5 (commencing with section 11500) of part 1 of division 3 of title 2 of the Government Code, and in all cases the Commissioner has all powers granted therein. During any period when its registration is revoked, a former registrant shall not offer or provide a subject product to California residents except as **may be permitted** by order of the Commissioner.
[Emphasis added.]

The use of the word “may” implies that the Commissioner will not always revoke the registration when failure to comply with the annual reporting requirements occurs but will instead consider some factors when deciding whether to revoke or not revoke the registration. The proposed regulation does not specify these factors.

Further the proposed regulation requires the registrant to file the report within 10 days after notice by the Commissioner. It is not clear whether the ten days begins when the notice is sent or when it is received. For these reasons, proposed section 1041, subdivision (c) and proposed section 1040, subdivision (a), are unclear because they can be reasonably and logically interpreted to have more than one meaning and they are not easily understood by those directly affected by them. (Cal. Code Regs., tit. 1, sec. 16, subd. (a)(1) and Gov. Code, sec. 11349, subd. (c).)

1.4 Proposed Section 1051, Subdivisions (a) and (b) – Surrender of Registration

Proposed section 1051 is unclear regarding the procedures required to be followed when surrendering a registration and when the surrender of a registration becomes effective. It states, in relevant part:

1051. Surrender of Registration.

(a) An application to surrender a registration shall be filed on Form MU1 with NMLS **in accordance with the procedures for transmission to the Commissioner.**

(b) Surrender of a registration becomes effective **when the Commissioner approves the application** for surrender.

[Emphasis added.]

The ISOR explains that “[t]he purpose of these subdivisions is to provide the process for surrendering a registration. Subdivisions (a) and (b) are necessary to enable registrants to

surrender their registration and to clarify that the Commissioner’s approval is required to surrender a registration.”

However, the proposed regulation does not describe any procedures that the directly affected public must follow to transmit the application to surrender the registration. It also does not establish the factors considered by the Commissioner when deciding whether to approve or deny the application. For these reasons, proposed section 1051, subdivisions (a) and (b), are not easily understood by those directly affected by them. (Gov. Code, sec. 11349, subd. (c).)

1.5 Proposed Section 1461, Subdivisions (a) and (b) – Obligors and Finance Lenders

The language in proposed section 1461, subdivision (a), conflicts with proposed section 1461, subdivision (b). These provisions state:

1461. Advances Under the California Financing Law

(a) **Any advance of funds** to be repaid in whole or in part by the receipt of a consumer’s wages, salary, commissions, or other compensation for services **is a sale or assignment of wages and loan subject to the California Financing Law**, regardless of the funding provider’s means of collection, whether the provider has legal recourse if the provider is unable to collect the amount it advanced, or whether the consumer has the right to cancel collection of the amount advanced. **This section does not apply to obligors** as defined by California Code of Regulations, title 10, section 1004, subdivision (h), who advance from their own funds only income that has accrued to the benefit of a consumer but has not, at the time of the advance, been paid to the consumer.

(b) A consumer who receives an advance **under subdivision (a)** of this section is a borrower and **a provider who makes an advance is a finance lender within the meaning of the California Financing Law.**

(c)...

[Emphasis added.]

The first sentence of subdivision (a) describes a sale or assignment of wages and a loan subject to the California Financing Law. The second sentence of subdivision (a) excludes some obligors who advance funds from being subject to this section. However, subdivision (b) refers to any provider who makes an advance under subdivision (a) as a “finance lender within the meaning of the California Financing Law.”

The exclusion of obligors from the California Financing Law in the second sentence of subdivision (a) conflicts with the language in subdivision (b), which includes these obligors in the application of the California Financing Law. This internal inconsistency renders the proposed regulation not easily understood by those directly affected by them. (Gov. Code, sec. 11349, subd. (c).)

1.6 Proposed Subdivision 1021(a)(2)(D) – EWA business activities

Subdivision (a)(2)(D) instructs the applicant to provide the following information: “For income-based advances, an applicant shall select the applicable ‘Earned Wage Access’ business activity under the Consumer Finance section of the form.”

Form MU1 is incorporated by reference in proposed section 1000, subdivisions (g), with a revision date of “09/12/2015.” This version of the form does not have an “Earned Wage Access business activity” listed under the Consumer Finance column for the applicants to select. For these reasons, proposed section 1021, subdivision (a)(2)(D), is not easily understood by those directly affected by it. (Gov. Code, sec. 11349, subd. (c).)

Furthermore, if the Department intends to use a different version of a form that lists earned wage access business activities, the Department must modify proposed section 1000, subdivisions (g) and (h), to update the revision date of the documents incorporated by reference, in compliance with CCR, title 1, section 20. The Department must also notice the modified regulation text to the public for a 15-day comment period pursuant to Government Code section 11346.8.

2. FAILURE TO FOLLOW REQUIRED APA PROCEDURE

The APA and OAL's regulations require agencies to follow specific procedures when conducting a regulatory action. In this action, the Department did not comply with the following procedures.

2.1 Documents Incorporated by Reference Not Attached to the Form 400

The APA and OAL's regulations require agencies to follow specific procedures when conducting a regulatory action. In this action, the Department did not attach the documents incorporated by reference to the Form 400.

The proposed regulations incorporate by reference two documents: Form MU1 and Form MU2.

CCR, title 1, section 20, subdivision (e), provides:

Where a regulation which incorporates a document by reference is approved by OAL and filed with the Secretary of State, the document so incorporated shall be deemed to be a regulation subject to all provisions of the APA.

And CCR, title 1, section 6, subdivision (a), requires, in relevant part:

For all regulatory actions submitted in hard copy to OAL for publication in the California Code of Regulations and/or transmittal to the Secretary of State for filing, the agency must include three copies of the certified regulation text.

The regulation text submitted to OAL did not include the two forms incorporated by reference. Upon resubmittal, the Department must attach both forms incorporated by reference to the regulation text.

CONCLUSION

For the foregoing reasons, OAL disapproved the above-referenced regulatory action. Pursuant to Government Code section 11349.4, subdivision (a), the Department may resubmit revised regulations within 120 days of its receipt of this Decision of Disapproval of Regulatory Action. A copy of this Decision will be emailed to the Department on the date indicated below.

Any substantive regulatory text changes necessary to address the deficiencies discussed above must be sufficiently related to the originally noticed text and be made available for public comment for at least 15 days pursuant to subdivision (c) of Government Code section 11346.8 and section 44 of title 1 of the CCR. Any objections or recommendations raised by the public during the 15-day public comment period must be summarized and responded to in the Final Statement of Reasons. The Department must resolve all issues raised in this Decision of Disapproval of Regulatory Action prior to the resubmittal of this regulatory action. OAL reserves the right to review the Department's resubmitted regulations and rulemaking record for compliance with all substantive and procedural requirements of the APA.

If you have any questions, please do not hesitate to contact me at (916) 323-6824.

Date: May 3, 2024

Thanh Huynh

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