

# BUCKLEY KOLAR LLP

## Legal Update

# 2006 California Legislative Developments for Financial Service Companies

The conclusion of the 2006 California legislative session was a welcome respite from previous years—the Legislature tinkered with existing statutes instead of producing new statutory or regulatory schemes. (Whether or not this was due to the counter-balance of a Republican Governor to a sizable Democratic majority in the Legislature is open to debate.)

Nevertheless, despite the absence of major modifications to the laws affecting the licensing and operation of financial service companies, numerous “tinkering” amendments were adopted and signed by the Governor—many of which may require review and implementation.

For ease of discussion, this summary is divided into the following functional areas of interest to financial service companies: (a) lending; (b) privacy/identity theft; (c) licensing/regulatory; (d) deposit; and (e) miscellaneous topics of concern to financial service companies.<sup>1</sup>

## A. Lending

### Chapter 365—AB 2416—Automated Valuation Models

The California Finance Lenders Law (the “CFL”) limits the fees that may be imposed by a licensed lender when charging a borrower for a real property appraisal.

AB 2416, which was approved by the Governor on September 20, 2006, adds a new Section 22317.2 to the consumer loans chapter of the California Financial Code, and permits a CFL licensee to collect a fee for an automated valuation model<sup>2</sup>—but the charge must be an actual pass-through of the fee charged by the third-party provider.

A finance lender may not charge a borrower for both an appraisal and an automated valuation for the same transaction. However, if a fee for an automated valuation model result has been paid, an appraisal fee minus the amount that has been paid by the borrower for the automated valuation model

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<sup>1</sup> Please note that, except where otherwise indicated, the chaptered laws discussed in this summary generally became effective on January 1, 2007. This summary is being provided for informational purposes only; the reader is advised to consult with legal counsel for a detailed analysis of the various statutes discussed herein.

<sup>2</sup> An “automated valuation model” is defined under the CFL as a computerized property valuation system that is used to obtain a real property valuation.

result may be charged for an appraisal for the same real property within one year if the borrower has obtained a new or additional loan.

It should be noted that, in a manner similar to the notice of the right to obtain a copy of an appraisal that must be provided to a consumer, a notice must be provided regarding the right to receive a copy of the automated valuation. The language of the statute states that the notice must be given “as a separate document,” which strongly suggests that no other information may be contained on the same disclosure form.

### **Chapter 410—AB 594—“Rental-Purchase” Personal Property Agreements**

Section 1812.622 of the California Civil Code (the “Civil Code”) governs the terms and conditions of “rental-purchase agreements.” These so-called “rent to own” agreements allow consumers to lease personal property, such as computers and furniture, and acquire ownership following the completion of the payments.

AB 594, which was signed by the Governor on September 20, 2006, specifies by formula the pricing mechanisms and the determination of the actual cost to a lessor of the property. The chaptered law also revises the disclosures that must be contained in rental-purchase agreements and adds new provisions that prohibit certain terms from appearing in these agreements.

It should be noted that this form of purchasing is similar to installment sales contracts, but without the inclusion of a time-price differential. However, the statute creates complicated requirements for structuring a rental-purchase agreement. More importantly, if either the calculation of the cash price or of the total of payments required to obtain ownership is incorrect, the contract is void and ownership is transferred to the consumer as a matter of law.

While this is not a financing scheme typically engaged in directly by financial institutions, this chaptered law is worthy of note because a financial institution could be involved in underwriting a retail personal property business that assigns rental-purchase agreements as security for a commercial loan or for a similar financing transaction.

### **Chapter 80—AB 1203—Mobile Homes and Manufactured Housing**

AB 1203, which was signed by the Governor on July 20, 2006, adds a new Section 18035.26 to the California Health & Safety Code, clarifying the manufactured home (also known as a mobile home) closing process as applicable to manufactured homes to be installed by the buyer on a foundation system. The chaptered law provides, among other things, that the sale of these homes is complete “at the close of escrow,” which is when a prescribed document containing a declaration of delivery sale and specifying the expiration date of the manufacturer’s warranty is executed, all funds in the escrow accounts are disbursed, and the buyer takes delivery of the manufactured home.

It should be noted, however, that AB 1203 requires that a new disclosure be provided to the purchaser, as well as a notice regarding the expiration of applicable warranties.

### **Chapter 51—SB 504—Real Property Sales Contracts**

In order to avoid criminal liability to sellers of condominium units that use a conditional public report issued by the California Department of Real Estate, the definition of a “real property sales contract” has been amended in Section 2985 of the Civil Code to exclude those instruments from coverage, provided that the conditional public report is subject to Section 11018.12 of the Business & Professions Code.

### **Chapter 254—SB 1481—Commercial Code**

This chaptered law adopts for purposes of the California Commercial Code and the Civil Code, among others, the revisions to Articles 1 and 7 of the Uniform Commercial Code proposed by the National Conference of Commissioners on Uniform State Law.

### **Chapter 202—SB 1609—Reverse Mortgages**

In response to growing concern that reverse mortgages could be used in a predatory fashion, California adopted SB 1609, placing new limits on reverse mortgages.

First, SB 1609 prohibits a reverse mortgage lender or a broker arranging a reverse mortgage loan from offering an annuity to the borrower or referring the borrower to anyone for the purchase of an annuity prior to the closing of the loan or before the expiration of the borrower’s right to rescind.

Second, this chaptered law, among other things, requires a lender to refer a prospective borrower to a housing counseling agency for counseling, as specified, prior to accepting a final and complete application for a reverse mortgage or assessing any fees. The bill prohibits a lender from accepting a full and complete application for a reverse mortgage loan or assessing any fees without receiving a certification that the borrower has received this counseling. (This provision parallels current FHA requirements in connection with the HECM program.) The statute also requires a lender to provide a specified list of independent loan counselors and makes changes to the disclosure notice provided to an applicant for a reverse mortgage.

Third, existing law requires any person engaged in a trade or business who negotiates primarily in Spanish, Chinese, Tagalog, Vietnamese, or Korean in the course of entering into specified contracts to deliver to the other party, prior to the execution of a contract or agreement, a translation of it in the language in which it was negotiated. The chaptered law includes contracts for reverse mortgages within these provisions.

Last, the bill requires a lender to ensure compliance with these provisions in the case of brokered loans.

### **Chapter 842—AB 1169—Residential Lease Termination Notice**

This chaptered law adds Section 1946.1 of the Civil Code to require that a lessee of residential real property must be provided notice 60 days prior to the termination of a lease. If the lessee has been in possession of the property for less than one year, the lessor must give 30 days notice prior to termination.

## **B. Privacy/Identity Theft**

### **Chapter 10—AB 424—Identity Theft**

California has taken a leadership role in creating remedies for identity theft. Chapter 10 expands the state identity theft scheme by providing additional alternatives to victims of identity theft, including obtaining a court determination of an individual's innocence should a crime be committed using that person's stolen identity.

In particular, the California Penal Code now permits an individual to obtain account records from a financial institution that has opened an account or provided credit or services based upon a stolen identity. Time frames are established within which a financial institution must provide records relating to the identity theft and to the related account. AB 424 also creates a statutory cause of action for failure to comply, as well as civil penalties and attorneys' fees.

The authority to take advantage of these remedial procedures is available not only to individuals, but also to business entities, including associations, partnerships, limited liability partnerships, limited liability corporations and general corporations. Similarly, the scope of entities that could commit identity theft crimes has been expanded to include such business organizations.

While the identity theft remedial provisions are relatively straightforward in approach, these compliance obligations could easily be misunderstood by operating staff at an institution. Care should be taken to create policies and procedures to respond to demands for account and identity theft information, as well as to correct inadvertent failures to provide information. In addition, the receipt of information regarding an alleged identity theft situation may also require an institution to evaluate any reporting that has occurred to a credit reporting agency, including the obligation to notify a CRA of the possibility that credit theft has occurred as the victim.

### **Chapter 705—AB 618—Provision of Surveillance Images to Law Enforcement**

Section 7480 of the California Government Code requires a bank or other FDIC-insured institution to provide certain account information after law enforcement authorities certify that a crime report has been received relating to the fraudulent use of a check, a draft, access cards or other orders drawn on that institution.

This chaptered law modifies those provisions by also requiring that the bank or other institution provide, if available, "surveillance photographs and video recordings of persons accessing the crime victim's financial account via an automated teller machine (ATM) or from within the financial institution for dates on which illegal acts involving the account were alleged to have occurred." Compliance by a financial institution carries with it the absolute immunity against liability provided by Section 47 of the California Civil Code, following disclosure to law enforcement officials.

### **Chapter 682—SB 1699—Truncation of Accounts**

Under existing law, a person who accepts a credit or debit card for payment may not print more than the last five digits of the account number or the expiration date on a receipt provided to the cardholder. However, no restrictions had been placed on a receipt retained by the person accepting the card. SB 1699 now extends the truncation requirement to retained receipts.

The requirement applies to receipts printed at the time of the purchase, exchange, refund, or return, which are signed by the cardholder, or which are unsigned because the cardholder used a personal identification number to complete the transaction. As with the existing law, the requirement applies only to receipts that include an account number that is electronically printed, and not where the number is recorded solely by handwriting or by an imprint or copy of the card. The statute clarifies that it does not apply to documents used for internal administrative purposes that are not printed at the time of the transaction.

Financial institutions may be directly affected by the bill to the extent that they accept cards as payment for services. The bill has a delayed effective date of January 1, 2009 to permit affected persons to upgrade their equipment.

#### **Chapter 160—SB 1390—Identity Theft Annual Report**

This chaptered law includes identity theft as a category of crime statistic that must be reported to the Governor. Specifically, the bill requires that the number of arrests for violation of Section 530.5 of the California Penal Code be included in the annual report to the Governor.

#### **Chapter 626—SB 202—Telephone Calling Lists**

This chaptered law now makes it a crime to sell purchase, sell, offer to purchase or sell, or conspire to purchase or sell, without the written consent of the subscriber, or procure through fraud or deceit, a telephone calling pattern record or list. In light of efforts that may be made in regard to collection of debts, the practice of obtaining calling patterns to identify or to locate a debtor is now illegal.

### **C. Licensing/Regulatory**

#### **Chapter 376—AB 2038—California Escrow Law**

Section 17000 *et seq.* of the California Financial Code contains one of the three statutory schemes for escrow entities operating in California. As part of that regulatory system, the Escrow Agents' Fidelity Corporation provides indemnification to its members for the actions of individuals employed by a licensed escrow company.

This chaptered law clarifies the application and certification procedures used by the Fidelity Corporation, including prohibitions on individuals denied fidelity coverage from participating in funding-type activities engaged in by a member escrow company

#### **Chapter 347—AB 2367—California Escrow Law—Criminal Penalties**

The California Escrow Law was amended to add determinate sentences for violations of the statutes. Section 17700 of the California Financial Code now provides that willful violations of applicable California law will result in a penalty of not more than \$10,000 and imprisonment of not more than one year.

#### **Chapter 107—AB 2602—Payment of Interest and Benefits to Real Estate Brokers**

Chapter 107 modifies the California Financial Code by permitting the payment of interest and other benefits to real estate brokers who deposit with a financial institution funds relating to services in connection with a real estate loan. This statute is an attempt to resolve ambiguity created by a provision of the California Business & Professions Code that arguably prohibited such payments.

Although the statute appears to resolve the legal issue, care should be exercised when structuring payment and other compensation arrangements, including obtaining acknowledgement of the consent of the borrowers, as well as compliance with other laws, such as the Real Estate Settlement Procedures Act.

### **Chapter 493—AB 1363—Conservatorships and Guardianships**

This chaptered law, entitled the “Omnibus Conservatorship and Guardianship Reform Act of 2006,” makes numerous modifications to California laws that address the appointment and obligations of a conservator or guardian. Although few financial institutions act in these capacities, the procedural modifications made by this chaptered law should be reviewed by financial institution trust departments. In addition, AB 1363 amended Section 2401 of the California Probate Code by setting forth the fiduciary and investment obligations of a conservator or guardian.

### **Chapter 569—AB 2347—Trust Distributions**

This chaptered law, which modifies California’s version of the Uniform Principal and Income Act, specifies the methodology for allocating certain interests received by a trust and the distribution of the net income. In addition, the statute provides immunity to the trustee for compliance with the statutory formulae.

### **Chapter 84—AB 2042—Removal of Trustees**

This chaptered law amends the trust provision of the California Probate Code to expand the grounds upon which a trustee may be removed. Section 15642 of the Probate Code now specifies that a trustee may be removed by a court if the trustee is found to be substantially unable to manage the trust’s financial resources or is unable to resist fraud or undue influence.

### **Chapter 278—AB 2429—Real Estate Licensees**

In a victory for California attorneys, the California Real Estate Law has been amended to permit the California Department of Real Estate (the “DRE”) to waive the examination and education requirement for a real estate salesperson license for members of the State Bar of California.

### **Chapter 199—AB 790—Real Estate Brokers**

Although the DRE has not been recognized as an aggressive regulator, the Real Estate Law includes a host of violations that merit suspension, revocation or denial of a real estate broker license. To this list is now added “knowingly authorizing, directing, conniving at, or aiding in the publication, advertisement, distribution, or circulation of any material false statement or representation concerning his or her [the broker’s] designation or certification of special education, credential, or trade organization membership.”

**Chapter 201—AB 2890—Finance Lenders Law and Residential Mortgage Lenders Act**

In a manner similar to Chapter 199 (noted immediately above), the California Finance Lenders Law and the California Residential Mortgage Lenders Act have been amended to permit the California Department of Corporations to suspend or to bar a person from being employed by a licensee under the California Finance Lenders Law or the California Residential Mortgage Lending Act if the Commissioner of Corporations finds that the person has committed certain acts for the purpose of misleading the public regarding qualifications or experience (including special education or certification).

**Chapter 361—AB 2711—Travelers Checks and Payment Instrument Licensees**

The Travelers Checks Act and the Payment Instruments Law require that persons and entities regulated by those laws provide certain documentation to the California Department of Financial Institutions (the “DFI”). AB 2711 slightly modifies those preexisting requirements by mandating that the form of a travelers check and a deposit instrument be filed with the DFI.

## **D. Deposit**

**Chapter 459—AB 2011—Local Agency Investments**

The California Government Code has been amended to facilitate the receipt of government investments without having to pledge collateral. Specifically, Section 53601.8 has been added to the California Government Code to allow a local agency to invest up to 30% of its excess funds in an FDIC-insured or NCUA-insured institution, provided that funds in excess of insurance limits are placed in other insured institutions through the assistance of private entities specializing in that service.

**Chapter 90—AB 2439—Automatic Deposits of Tax Refunds**

AB 2439 amends the California Revenue and Taxation Code to permit taxpayers to deposit their tax refunds into several designated checking or savings accounts. This provision would permit, for example, a taxpayer to fund an IRA directly from a tax refund.

**Chapter 818—AB 2098—State Government Payment Systems**

This chaptered law evidences the belief that that the governmental payment systems for benefits and entitlements are out of date. The new law establishes an Electronic Funds Transfer Task Force that is directed to report to the California Legislature by April 1, 2008. Among other things, the task force has been directed to examine the prospect of providing electronic debit and similar access devices for state payments—particularly to the under-banked and non-banked.

## **Miscellaneous**

### **Chapter 488—AB 32—The California Global Warming Solutions Act of 2006**

The State of California has once again taken a leadership role in an area that arguably should be the province of the federal government. This act adopts a state version of a global warming approach that imposes on the California Energy Resources Conservation and Development Commission (the “Energy Commission”) the obligation to take the following steps: (a) develop regulations to report and to monitor greenhouse gases; (b) reduce by 2020 the level of greenhouse gases as emitted by the state in 1990; (c) develop a market-based approach to trading and measuring compliance; and (e) enforce by civil and criminal penalties the environmental requirements imposed.

This statute—which has received considerable national and international attention—presents several challenges and opportunities to financial institutions. First, financial institutions will be required to develop internal competencies regarding compliance measures, such as “brick and mortar” operations, commuting patterns for employees, and similar matters. Second, it is estimated that a multi-billion dollar economy will emerge for both providers and market-makers, which will undoubtedly impact underwriting considerations. Moreover, because of the significant regulation authority provided to the Energy Commission, constant monitoring of that administrative agency will be necessary to identify additional opportunities and compliance concerns.

### **Chapter 266—AB 1553—Arbitration: Tolling**

This chaptered law clarifies that the right to arbitrate within a stated period is tolled during the period that a lawsuit is filed regarding the controversy. The tolling period continues for a period of 30 days following a determination that the matter is subject to arbitration or is otherwise terminated.

### **Chapter 357—AB 2482—Arbitration: Legal Representation**

As a result of a prior judicial determination, an out-of-state attorney may represent a party in an arbitration taking place in California. Prior law—which expired on January 1, 2007—required the out-of-state attorney to notify parties to the arbitration and obtain a certificate permitting the representation.

This chaptered law extends that certification and notification procedure for an additional four years and requires the State Bar of California to monitor compliance.

### **Chapter 230—AB 1835—State Minimum Wage**

The minimum wage for employees in California has been raised to \$7.50 per hour commencing on January 1, 2007, and to \$8.00 commencing as of January 1, 2008. In addition, the California Labor Code has been amended to authorize the California Department of Industrial Relations to adjust lodging and meals credits by the same percentage increase as the increases in the minimum wage.

### **Chapter 215—AB 2034—Donative Transfers**

California law presumptively limits donative transfers to certain individuals, such as care givers and custodians. The prohibition may be overcome by the use of an independent attorney who must



counsel the donor of the consequences of the proposed gift, and who must certify the absence of fraud, coercion, undue influence, and duress.

Chapter 215 orders the California Law Revision Commission to undertake a study of this issue and to report to the California Legislature by January 1, 2009.

### **Chapter 277—AB 2369—Civil Warrants**

As an alternative to issuing a warrant for contempt in instances in which an attachment or judgment is being enforced, a court is now authorized to order the individual arrested, pursuant to Section 1993 of the California Code of Civil Procedure.

Although an extreme remedy, this coercive alternative provides greater incentive to a designated person to comply with an order for examination following the entry of a judgment.

### **Chapter 182—SB 1441—Discrimination**

State law prohibits discrimination on the basis of race, national origin, ethnicity, religion, age, sex, color or diversity. The prohibitions apply to any program or activity conducted, operated, funded or administered by the State of California or a California state agency.

Chapter 182 adds a new “sexual orientation” category and defines the terms “sex” and “sexual orientation.” Further, the statute adopts the principle that if California law provides greater protections than the Americans with Disabilities Act of 1990, the California law’s protections will govern.

Finally, the statute adds a “perception” component to the anti-discrimination provisions. The prohibitions on discrimination apply if there is a “perception” that any person has any of the listed characteristics or that any person associated with a person has, or is perceived to have, any of the characteristics.

### **Chapter 802—SB 1827—Domestic Partners State Tax Returns**

SB 1827 modifies several omissions to the California domestic partners law by providing that registered domestic partners have the same rights as married couples to file joint or separate state tax returns. Further, the statute confirms that the earned income of a registered domestic partner is treated as community income for California taxation purposes.

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