SW&M

FINANCIAL INSTITUTION ATTORNEYS

# 2022 YEAR END LEGAL UPDATE

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## I. INTRODUCTION

In terms of legal developments, 2022 broke the trend of "all COVID all the time." The urge of society as a whole to put the Novel Coronavirus behind us extended to legislatures and regulators. The reopening of courts brought new litigation updates and court decisions. However, many of the consumer protection and regulatory compliance updates are highly granular and specific. In California, though, a couple "sweeping" changes appeared which we expect to portend later national changes.

As with other years, we will discuss areas impacting financial institutions nationally, and then developments more limited to California. Below we also group discussions by general area, particularly where national and California developments overlap.

## II. FEDERAL OR NATIONAL REGULATIONS AND DEVELOPMENTS AFFECTING FINANCIAL INSTITUTIONS

Trends at a federal level have continued in the direction of consumer protection, though few major legal or regulatory developments have caused fundamental disruption to financial services—important details reign supreme!

### A. Federal Reserve Regulation II

In October 2022, the Federal Reserve Board of Governors enacted a change to the Debit Card Interchange Fees and Routing rules in Regulation II.[1] These revisions, effective July 1, 2023, clarify the Federal Reserve's intentions around debit card network exclusivity, and its application to card-not-present transactions.

Since 2011, Regulation II, enacted pursuant to the Durbin Amendment to the Dodd Frank Act, required debit card transactions to be able to route through two (2) unaffiliated networks. This clearly applied to debit card swipes with the card present. However, card-not-present transactions were left ambiguous for the important reason that in many cases, card-not-present transactions were not possible through single-message networks.

At this time, the Federal Reserve has assessed that those technological limitations are no longer present, and so is enacting the changes to Reg. II to fully enact the Dodd Frank Act's provisions.

The Final Rule requires that issuers (financial institutions issuing the debit cards):

1. Have networks enabled in their system such that the combination of networks does not result in only one network being available for a geographic area, specific merchant, type of merchant, or type of transaction.

[1] 12 C.F.R. Part 235.

2. Have its enabled networks take steps reasonably designed to be able to process the electronic debit transactions that they would expect will be routed to it, based on expected transaction volume.

These changes will largely be enacted through:

- Review of debit processing agreements to ensure that they do not prevent use of multiple networks.
- Review of debit processing systems to ensure that they have at least two networks enabled for each type of transaction. For example, Network A might have both card present and card-not-present transactions available, but Network B might only have card present enabled, and Network C might have only card not present enabled—such a combination would comply with the rule.
- Engage in projections of reasonably expected volume of various types. This should include review of transaction data (single message vs. dual message, card present vs. card-not-present)
- Engage networks as necessary to ensure that any additional network arrangements are made, and that all networks have agreed that they will be able to meet anticipated volume or will expand to meet it.

These revisions may have an impact on debit interchange, as provision of more network choice for merchants may lead to their sending transactions through lower cost networks. Another impact may also include increased fraud experience due to merchant transmission over single-message networks. While the Federal Reserve anticipates that these rules will drive innovation and lower costs to consumers, naturally the impact remains to be seen.

## B. Credit Union Governance Modernization Act-Expelling Members for Certain Offenses

On March 15, 2022, Congress enacted the Credit Union Governance Modernization Act[2] with provisions to assist federal credit unions in more efficiently expelling members for certain offenses. The Act, however, was not self-effectuating, and requires the NCUA to enact regulations within eighteen (18) months of the enactment date. Accordingly, in September 2022, the NCUA Board proposed rules to effectuate this, primarily by amending the FCU Bylaws in Part 701 Appendix A.

The Act itself is not a panacea, and has certain key flaws. It will remain to be seen whether the NCUA's rules will be able to fix those flaws.

Particularly, the Act adds a provision to the expulsion provisions under 12 U.S.C. § 1764. This does not eliminate the ability of a credit union to expel members by a member vote at a special meeting of the members, nor does it remove expulsion under a nonparticipation policy. The added expulsion mechanism is a 2/3 vote of a quorum of the Board. The prerequisites under the Act for expulsion are:

[2] Public Law 117-103 (Mar. 15, 2022).

- "Cause" for the expulsion.
- Distribution of "a policy the [NCUA Board] shall adopt" to "each member" of the FCU. Note here that for expulsion of any one member, all members must receive the policy.
- The aforementioned Board vote.
- A notice to the member, by mail, email (if consented to by the member), or personal service.
- 60 days from the date the member receives the notice for the member to send their request for a hearing. Note that the clock under the Act only starts upon the member actually getting the notice, which is particularly problematic for use of mail, absent NCUA clarification in its rules.
- If requested, a hearing by phone or electronically (it can't be in writing—it must be oral, but is not required to be in person).
- Notice of the expulsion provided by mail (or email) to the member informing them of the actual expulsion.

Note that while the Act provides that if the member does not request a hearing by the end of the 60 day notice period, they are automatically expelled, for many modes of delivery, the FCU will not know when that 60 day period ends. For regular mail transmission, there would be no possible method of assurance that it would ever end. Accordingly, members who have PO Boxes and who have not consented to electronic communications would be very expensive to expel—personal service would be essentially required.

Note that "cause" is the standard above. The Act also closely defines "cause" here:

> "(A) a substantial or repeated violation of the membership agreement of the Federal credit union;
> (B) a substantial or repeated disruption, including dangerous or abusive behavior (as defined by the National Credit Union Administration Board pursuant to a rulemaking), to the operations of a Federal credit union; or
> (C) fraud, attempted fraud, or other illegal conduct that a member has been convicted of in relation to the Federal credit union, including the Federal credit union's employees conducting business on behalf of the Federal credit union."

Observe that illegal conduct (other than fraud, for which there is room for interpretation) is required to be "in relation to the" FCU. This would not permit expulsion as a result of illegal acts that do not have to do with the credit union.

We also observe that while violation a "membership agreement" is "cause," causing a loss to the credit union is not. The NCUA has contemplated this area, and so long as the NCUA does not prohibit expulsion for losses under its rules, FCUs will be in a position where they need to ensure that causing a loss under loan agreements is included as a "cross default" under the credit union's "membership agreement" (which we have assumed means deposit agreements and membership application).

An important element of this Act is that it has the potential to upend and supplant decades of practice under the "member not in good standing" doctrines. Under decades of NCUA Legal Opinion Letters, and most recently the NCUA's 2019 Bylaws, FCUs have had the ability to limit services to members who are "not in good standing." Ways to become "not in good standing" have included abuse of services, violent, disruptive, or harassing behavior, or causing a loss. Under the NCUA's September Proposed Rule, the NCUA would have eliminated this concept from the Bylaws, allowing limitation of services also only for the "cause" concepts from the Act. If finalized as proposed, this could significantly change limitation of services and member relations tools in major ways.

With the Proposed Rule's comment period ending December 2, 2022, we expect a few months before seeing a new proposal or a Final Rule. Accordingly, it would be premature to rework Account Agreements, Membership Applications, or Bylaws at this time. But FCUs should add to their project plans and governance calendars that at some time in the latter half of 2023, each of these elements will be an important consideration for action.

## C. LIBOR

On June 30, 2023, the USD London Interbank Offered Rate (LIBOR) will stop being published. By now, your financial institution should have processes in place to transition any loan obligations that use LIBOR to set interest rates to a new index. Here are some of the key things to keep in mind as we move within six (6) months of the LIBOR cessation date:

### Fallback Provisions

Generally, financial institutions will be relying on fallback provisions in their loan documents to change the index once the LIBOR stops being published. Many loan documents contain robust fallback language that specifically addresses the cessation of an index under certain circumstances and the acceptable types of replacements. For example, the current version of the standard Fannie Mae Multistate Adjustable Rate Note defines the specific circumstances under which an index is deemed to be no longer available (i.e., an Administrator of the index has stopped publishing the index or issued a public statement saying that the index is not reliable or representative) and how a replacement index will be chosen (either by an index recommended by the FRB or a committee endorsed by the FRB, or by choice of the lender on the condition that the new index and new margin will minimize any changes in the cost of the loan). Such provisions provide the "cleanest" mechanism for financial institutions to change the index once LIBOR stops being published.

### The LIBOR Act

In some cases, loan documents contain insufficient fallback provisions or no fallback provisions at all. Such loans fall within the purview of the Adjustable Interest Rate Act (the "LIBOR Act"), which was signed by President Biden in March of 2022. The LIBOR Act authorized the FRB to establish a benchmark replacement index and tenor spread adjustment for contracts that use LIBOR but do not have sufficient fallback provisions or that have a fallback provision based on the use of LIBOR.

In December 2022, the FRB announced that it has passed a final regulation to implement the LIBOR Act. The new rule applies to LIBOR contracts that contain:

- No fallback provisions
- Fallback provisions that identify neither a specific benchmark replacement nor a determining person
- Fallback provisions that identify a determining person, but the determining person has not selected a benchmark replacement by the earlier of the LIBOR replacement date and the latest date for selecting a benchmark replacement pursuant to the terms of the LIBOR contract

For purposes of the FRB's rule, a "determining person" is any person with the sole authority, right, or obligation to determine a benchmark replacement pursuant to the terms of the LIBOR contract or the governing law of the LIBOR contract.

For these types of covered contracts, the LIBOR Act and the FRB's LIBOR rule provide that by operation of law, the FRB selected benchmark replacement will be the benchmark replacement for LIBOR in the covered contract. No modifications of the loan are required and financial institutions are entitled to statutory protection from liability for claims from consumers based solely on the change to the FRB selected replacement.

For consumer loans, the FRB selected alternative rate for one, three, six or twelve month tenors of LIBOR is an amount equal to the corresponding one, three, six, or twelve month tenors of CME Term SOFR plus the applicable tenor spread adjustment identified in the new regulation. For example, the tenor spread adjustment for the six-month LIBOR is set forth in the rule as 0.42826 percent. Thus, the alternative rate for the six-month LIBOR rate is the six-month CME Term SOFR plus 0.42826. The FRB has advised that the rates published by Refinitiv Limited as "USD IBOR Cash Fallbacks" for consumer products will equal the FRB selected rate. These rates are available to be viewed at https://www.refinitiv.com/en/financial-data/financial-benchmarks/usd-ibor-cash-fallbacks.

Regulation Z

It is important to note that notwithstanding the LIBOR Act or any fallback provisions that appear in existing loan documents, financial institution obligations with respect to borrower notice and disclosure requirements under Regulation Z. For example, under Regulation Z, a creditor is required to provide new disclosures when a refinancing of an existing obligation occurs. Per the CFPB's commentary to Regulation Z, a refinancing occurs when a creditor:

> "Adds a variable-rate feature to the obligation. A creditor does not add a variable-rate feature by changing the index of a variable-rate transaction to a comparable index, whether the change replaces the existing index or substitutes an index for one that no longer exists. For example, a creditor does not add a variable-rate feature by changing the index of a variable-rate transaction from the 1-month, 3-month, or 6-month U.S. Dollar LIBOR index to the spread-adjusted index based

> on SOFR recommended by the Alternative Reference Rates Committee for consumer products to replace the 1-month, 3-month, or 6-month U.S. Dollar LIBOR index respectively because the replacement index is a comparable index to the corresponding U.S. Dollar LIBOR index."

We note that like the FRB selected benchmark rate above, the USD LIBOR Cash Fallback rate is the ARRC recommended SOFR based replacement for LIBOR. As such, to the extent a financial institution is using the USD IBOR Cash Fallback rate published by Refinitiv as a replacement for LIBOR in its variable rate loan agreements, there should be no need for providing new disclosures to borrowers as it would had a refinancing occurred.

Regulation Z also requires lenders to provide advance notice to borrowers in connection with its adjustment of an interest rate pursuant to a loan contract that results in a corresponding adjustment to the payment. Such a disclosure must be provided to the borrower at least 60, but no more than 120 days before the first payment at the adjusted level is due. For initial interest rate adjustments made pursuant to a loan contract, the lender is required to provide notice at least 210, but no more than 240 days before the first payment at the adjusted level is due. When delivering these notices to inform borrowers of adjustments that occur after LIBOR is no longer being published, financial institutions should be sure to inform borrowers of the new index that will be used to calculate their interest rates.

## III. GOVERNANCE – CREDIT UNION ANNUAL MEETINGS

During COVID-19, NCUA and various state regulators made allowances for credit union member annual meetings. State legislatures made certain changes to state law—we have reported on changes to California law in last year's Year End Legal Update. Specifically, these allowances were to allow for member meetings to be conducted entirely virtually.

For federal credit unions, the NCUA announced in Letter to FCUs 22-FCU-03[3] that COVID-19-based virtual meeting allowances were coming to an end as of December 31, 2022. This end of NCUA's completely-virtual annual meeting allowances has been coming for some time. Indeed, the NCUA's authority in this area was always limited—the Federal Credit Union Act requires a meeting to occur in a place, and the NCUA interprets that as requiring a meeting occur physically in a place.

For California chartered credit unions, the NCUA's guidance does not directly apply. However, the substance of it still holds true. California Corporations Code § 7510 requires that meetings cannot occur entirely electronically unless (1) all members consent, or (2) there is an emergency and Bylaws adequately provide emergency powers. Because it is highly unlikely we will get electronic meeting consent from all members, California institutions will need to also switch back to having in person meetings. Note that the California COVID state of emergency ends in February 2023.

[3] https://www.ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/expiration-emergency-exemption-certain-person-meeting-requirements

We note that California institutions may hear about AB1780, which applies to California general corporations by amendment to Corporations Code § 600. AB1780 allows general corporations to conduct virtual meetings without 100% shareholder consent, provided that there is either an emergency (as with nonprofit mutual benefit corporations) or there is a live audiovisual broadcast of the meeting. For the latter, corporations have that authority until 2025. Note that this is a change to § 600, not to § 7510. Accordingly, it does not apply to credit unions.

## IV. PRIVACY & TECHNOLOGY

Our 2022 Summer Legal Update significantly addressed privacy developments in California, specifically the California Privacy Rights Act ("CPRA"), a fundamental change to the California Consumer Privacy Act ("CCPA"). Additional privacy and other technology regulating laws have been in development in California which will impact institutions around the country.

### A. CPRA Regulation Update

While the new provisions of the CPRA are scheduled to take effect on January 1, 2023, regulations and other clarifications in this area continue to develop. By way of background, in May 2022, the California Privacy Protection Agency (for purposes of this section, the "Agency") released its initial draft of proposed regulations to implement the CPRA and provide businesses with guidance to comply. To date, the regulations have yet to be finalized. Since the summer, the Agency has significantly modified its initial draft of Regulations. In this section we briefly address some of the more compelling updates to the initial proposals.

May 2022 Proposed Regulations Recap

One of the major topics covered in the initial regulations addressed the concept of "data minimization" that was introduced by the CPRA in 2020. Data minimization meant that businesses were restricted to collecting, using, retaining, and sharing a consumer's personal information only for purposes that are "reasonably necessary and proportionate to achieve the purposes for which the personal information was collected or processed or for another disclosed purpose that is compatible with the context in which the personal information was collected." The regulations provided further explanation for what the CPRA means by "reasonably necessary and proportionate" and provided several examples illustrating the concept. According to the initial regulations, the key to determining what is reasonably necessary and proportionate is by considering what an average consumer would expect.

The initial regulations also addressed some of the requirements for how businesses use, retain, or disclose consumers' personal information. The Agency provided clear guidance regarding the distinctions and the interrelationship between service providers, contractors, and third parties. The proposed regulations also established contractual requirements between the covered business and its service providers or contractors. While the regulations addressed service providers, contractors, and third parties at length, it was noted that the regulations failed to provide any guidance on other topics on how businesses can utilize personal information. Specifically, the regulations did not address the CPRA requirements for businesses to implement "reasonable" security practices and procedures to protect from unauthorized or illegal access, destruction, use,

modification or disclosure. The regulations also failed to provide any guidance about a business's use of automated decision-making in handling consumer personal information.

Further, the initial proposals offered some guidance for businesses to handle consumer requests to know, correct, delete, or opt-out of collection. The proposed regulations established what constitutes "dark pattern" practices, which are practices designed to substantially subvert or impair a consumer's autonomy, decision-making, or choice. Strict timelines for when a business must confirm receipt of a consumer's CPRA request and by when the business must respond to the request were established. The regulations even outlined how an effective operation for handling requests would look. The Agency specifically outlined how businesses are expected to handle a consumer's requests to opt-out with "simple and easy-to-use" opt-out preference signals.

While the initial proposed regulations were a start to helping businesses implement compliant processes, the Agency still needed to address additional topics and provide further detail and guidance before the regulations could be finalized.

<u>October/November 2022 Modifications</u>

After a 45-day period for comments, modifications to the proposed regulations were released on November 2, 2022. The Agency provided more detail and clarified some of the remaining issues less than two months before the CPRA becomes effective. These modified regulations are expected to closely resemble how the finalized regulations will look.

*Additional Definitions and Details*

The modified proposed regulations include several new definitions. The Agency provided a new definition of "disproportionate effort," for example. Businesses are permitted to decline certain consumer CPRA requests when the business can show that compliance with the request would require disproportionate effort. The revised definition provides businesses with factors to consider in making such a determination. Those factors will include the size of the business, the nature of the request, and any technical limitations of the business. The new definition also expressly includes service providers, contractors, and third parties, allowing those parties to evaluate whether any disproportionate effort exists on its part to respond to a consumer's CPRA request.

Along with the new definitions, the modified proposed regulations also provide some further guidance for what the CPRA means in restricting the collection and use of personal information to what is "reasonably necessary and proportionate." The Agency breaks down this determination into three parts: (1) factors upon which businesses can determine a consumer's reasonable expectations, such as the consumer's relationship with the business and the type and nature of the personal information at issue; (2) factors to determine compatibility with the disclosed purpose; and (3) further considerations such as possible negative impacts on the consumers and the existence of additional safeguards to address those negative impacts.

*Less Requirements for Disclosures to Consumers*

Businesses are required to provide certain notices to consumers when collecting or processing consumer personal information. The modified regulations eased some of the requirements for disclosure to consumers. Businesses will no longer have to identify the names of third parties in the Notice of Collection, which will simplify the process. Another revision that will simplify compliance for businesses excludes businesses from providing the Notice of Right to Limit where the business only collects sensitive personal information with no intention of using sensitive personal information to infer characteristics about a consumer. Other, smaller revisions to the required disclosures will make it easier for businesses to be in compliance. Service Providers and Third Parties are also relieved of some of the requirements for disclosures listed in the earlier version of the proposed regulations, such as the requirement to provide an explanation to the covered business when it is denies a consumer's request to delete based on disproportionate effort.

*Further Guidance for Handling Consumer CPRA Requests*

The modified proposed regulations also provided clarification for how businesses are expected to handle a consumer's CPRA request. For example, the Agency provided further details for businesses handling a consumer's request to correct certain sensitive personal information like a social security number or driver's license number. The modified regulations state that the business cannot disclose such information to the consumer; rather, the business may only confirm whether the personal information that it maintains matches the personal information provided by the consumer. Also, the Agency made several revisions to a business's process for handling requests to opt-out, including an exemption from the opt-out preference signal requirement for businesses that do not participate in selling or sharing personal information. Businesses are also no longer required to display whether an opt-out request has been processed. That provision is now optional.

While the modified regulations may provide some relief to businesses with less requirements, some of the restrictions remain. Businesses are encouraged to utilize the most recent version of the proposed CPRA regulations to model new processes and procedures that will comply with the law once it becomes effective in the new year.

### B. AB2273: The California Age-Appropriate Design Code Act

The California Age-Appropriate Design Code Act ("Act") serves to create a coherent, comprehensive law that protects children under 18 from goods, services, and products that endanger their welfare. The Act is modeled on the UK's Age-Appropriate Design Code and imposes several affirmative requirements on businesses in addition to prohibiting certain data collection practices.

The Act applies to any business that provides an online service, product, or feature ("Online Service") likely to be accessed by children under 18 and meets the revenue or data-collection thresholds created by the CCPA. According to the Act, "likely to be accessed by children" means that it is reasonable to expect, based on certain indicators, that the Online Service would be

accessed by children. The indicators include whether the Online Service (i) is "directed to children," as defined by the federal Children's Online Privacy Protection Act ("COPPA"); (ii) is determined to be routinely accessed by a significant number of children (based on competent and reliable evidence regarding audience composition); (iii) has advertisements marketed to children; (iv) is substantially similar to, or the same as, an online service, product, or feature routinely accessed by a significant number of children; (iv) has design elements that are known to be of interest to children (including, but not limited to, games, cartoons, music, and celebrities who appeal to children); or (iv) a significant amount of the audience of the online service, product, or feature is determined, based on internal company research, to be children.

While COPPA governs the use and sharing of children's data once it has been collected, the Act goes further by requiring businesses to consider children during the development of a product or service. This includes considering the different needs of a child based on their age. The Act splits the age ranges of children into five developmental categories: 0 to 5 years of age or "preliterate and early literacy;" 6 to 9 years of age or "core primary school years;" 10 to 12 years of age or "transition years;" 13 to 15 years of age or "early teens;" and 16 to 17 years of age or "approaching adulthood." Moreover, whereas COPPA defines children as individuals under the age of 13, the Act differs from COPPA in that it defines children as individuals under the age of 18, a much broader demographic.

The Act has both affirmative requirements and a list of prohibited acts that apply to covered businesses. Among other obligations, the Act requires covered businesses to: (i) configure all default privacy settings offered by the online service, product or feature to those that offer a high level of privacy, unless the business can demonstrate a compelling reason that a different setting is in the best interests of children; (ii) concisely and prominently provide privacy information, terms of service, policies and community standards, using clear language suited to the age of the children likely to access the online service, product or feature; (iii) estimate the age of child users with a reasonable level of certainty appropriate to the risks that arise from the business's data management practices, or apply the privacy and data protections afforded to children to all consumers; (iv) if the online service, product or feature allows the child's parent, guardian or any other consumer to monitor the child's online activity or track the child's location, provide an obvious signal to the child when the child is being monitored or tracked; (v) enforce published terms, policies and community standards established by the business, including, but not limited to, privacy policies and those concerning children; and (vi) provide prominent, accessible and responsive tools to help children (or their parents/guardians) to exercise their privacy rights and report concerns. It should be noted, the Act prohibits the use of any additional information collected in order to estimate age or the age range of users to be used for any other purpose, and it can only be retained for as long as needed to estimate age.

Covered businesses are prohibited from using a child's personal information for any reason other than a reason for which the personal information was collected, unless the business can demonstrate a compelling reason that use of the personal information is in the "best interests of children;" or in a way that the business knows, or has reason to know, is materially detrimental to the physical health, mental health, or well-being of a child. Businesses cannot use dark patterns to lead or encourage children to provide personal information beyond what is reasonably expected to provide that Online Service, or to take any action that the business knows, or has

reason to know, is materially detrimental to the child's physical health, mental health or well-being. Covered businesses cannot collect precise geolocation information regarding a child without providing an obvious sign for the duration of the collection or collect, sell or share any precise geolocation information regarding children by default unless strictly necessary for the business to provide the Online Service and only while the collection of precise geolocation information is necessary to provide the service, product or feature. Covered businesses cannot profile a child by default unless the business has appropriate safeguards in place or profiling is necessary to provide the Online Service with respect to the aspects of the Online Service with which the child is actively and knowingly engaged or a compelling reason as to why profiling is in the best interests of children can be demonstrated.

Additionally, covered businesses will also be required to complete Data Protection Impact Assessments ("DPIAs") for online services, products and features likely to be accessed by children. The Act sets out several factors that must be addressed in a DPIA including (i) whether the design of the online product, service or feature could harm children, including by exposing children to harmful, or potentially harmful, content on the online product, service or feature; (ii) whether the design of the online product, service or feature could lead to children experiencing or being targeted by harmful, or potentially harmful, contacts on the online product, service or feature; (iii) whether the design of the online product, service or feature could permit children to witness, participate in or be subject to harmful, or potentially harmful, conduct on the online product, service or feature; (iv) whether the design of the online product, service or feature could allow children to be party to or exploited by a harmful, or potentially harmful, contact on the online product, service or feature; (v) whether algorithms used by the online product, service or feature could harm children; (vi) whether targeted advertising systems used by the online product, service or feature could harm children; (vii) whether and how the online product, service or feature uses system design features to increase, sustain or extend use of the online product, service or feature by children, including the automatic playing of media, rewards for time spent and notifications; and (viii) whether, how and for what purpose the online product, service or feature collects or processes sensitive personal information of children.

The Act provides that the California Attorney General may solicit broad public participation and adopt regulations, however, the Attorney General is not required to do so. Furthermore, there is no indication in the law as to what topics the regulations, if promulgated, would cover.

The Act also establishes the California Children's Data Protection Working Group, which will study and report to the legislature best practices for implementing the Act. The Working Group will consist of experts in children's data privacy, physical health, mental health and well-being, computer science, and children's rights. Among other topics, the Working Group is tasked with (1) identifying online services, products or features likely to be accessed by children; (2) ensuring that age-assurance methods used by covered businesses are risk-proportionate, privacy protective and minimally invasive; and (3) evaluating how the Working Group and the Department of Justice can leverage the expertise of the California Privacy Protection Agency in the long-term development of data privacy policies that affect the privacy, rights and safety of children online.

The California Attorney General is tasked with enforcing the Act and may seek an injunction or civil penalty against any business that violates its provisions. Violators may be subject to a penalty of up to $2,500 per affected child for each negligent violation, and up to $7,500 per affected child for each intentional violation. The Act provides for a potential 90-day cure period, if a covered business substantially complies with the Act.

Financial Institutions that have been preparing for compliance with the CPRA should simultaneously assess what steps they need to take to comply with the Act (which goes into effect on July 1, 2024), including potential compliance steps that can be addressed in parallel for both laws.

## V. CANNABIS BANKING UPDATES-FEDERAL & CALIFORNIA

Cannabis banking advocates have annually projected that it would be the year for Congressional action to either (a) de-schedule cannabis, or (b) protect cannabis banking from consequences under RICO and similar paradigms. In 2022, none of these proposals have significantly developed. Cannabis remains illegal at the federal level, SAR and similar reporting for cannabis banking remain high, and risks remain for cannabis banking. However, California (like other states) continues to develop its cannabis regulations.

### A. SB1326: Cannabis Interstate Agreements

Under the existing Medicinal and Adult-Use Cannabis Regulation and Safety Act, businesses that receive licensees to produce, transport, and distribute cannabis for medicinal or recreational purposes are generally prohibited from transporting or distributing cannabis or cannabis products outside the state of California, unless permitted by federal law. SB1326 looks to expand the capabilities of California licensed commercial cannabis businesses by authorizing the Governor to enter agreements with other states that would permit the licensees from each state to do business with each other, across state lines.

Under SB 1326, this interstate agreement, which would allow licensed entities from each state to engage in commercial cannabis activity with each other, would be subject to a number of conditions, including:

- The commercial cannabis activities are lawful and subject to licensure under the laws of the contracting state.

- The agreement prohibits both (1) the transportation of cannabis or cannabis products by any means other than those methods authorized under the laws of the contracting state and the regulations of the California Department of Cannabis Control, and (2) the transportation of cannabis or cannabis product through jurisdictions that do not allow the transportation of cannabis or cannabis product.

- The contracting state must impose requirements on foreign licensees that will produce cannabis or cannabis products that are sold in California that are equivalent to or exceed similar California requirements, such as standards for public health and safety, testing,

packaging and labeling, handling of adulterated or misbranded products, and marketing and advertising.

- The agreement includes provisions requiring regulators from each state to investigate issues of noncompliance with cannabis regulations in their respective states

- Foreign licensees are restricted from doing business in California without getting an appropriate state or local license or permit, as required.

Any agreement that the Governor signs in accordance with SB1326 would not take effect unless: 1) federal law is amended to permit the interstate transfer of cannabis or cannabis products, 2) federal law is enacted that specifically prohibits the expenditure of federal funds to prevent the interstate transfer of cannabis or cannabis products by authorized cannabis businesses, 3) the United States Department of Justice issues an opinion or memorandum tolerating the interstate transfer of cannabis or cannabis products by commercial cannabis businesses, or 4) the California Attorney General issues a written opinion that the state law authorization to enter these types of agreements will not result in significant legal risk to the state of California under the federal Controlled Substances Act.

Cannabis remains a hot button issue with federal politicians, and as such, it is unclear how close we may be to any action on the federal level that would lead to an SB1326 authorized agreement. However, to the extent your financial institution is actively serving commercial cannabis businesses in California, SB1326 based interstate agreements may require a fresh look at account agreements and contracts for provisions that serve to limit activity to the state of California.

### B. AB2568: Cannabis Insurance Providers

Under existing California law, commercial activity relating to medical or recreational cannabis conducted in compliance with California state and applicable local laws and regulations is expressly deemed to be the lawful object of a contract, not contrary to any express provision of law, and not against California public policy. This law was passed in order to ensure that commercial contracts related to cannabis were not subject to an "illegality" defense, whereby a party could void a contract on the basis that it had an illegal purpose under federal law. Despite this, California licensed insurers have been hesitant to provide insurance products to cannabis businesses. AB2568 is the Legislature's effort to encourage licensed insurers to work with cannabis businesses by amending the Business and Professions Code to expressly state that an insurer licensed by the California Department of Insurance does not commit a crime based solely on the fact that it provides insurance or related services to persons licensed to engage in commercial cannabis activity.

## VI. PROTECTIONS FOR MILITARY AND VETERANS

Consumer protections for servicemembers and veterans continue to be a legislative and regulatory priority. Note that the Military Lending Act ("MLA") and Servicemembers Civil Relief Act continue to be examination items for financial institutions.

### A. Federal Developments

As financial institutions may recall, from 2017 through 2020, significant ambiguity existed as to the application of the MLA to certain automobile loans for which GAP insurance was financed with the purchase of the vehicle. The Department of Defense ("DOD") had in 2017 issued guidance suggesting that "hybrid" loans, where some amount is not directly a purchase, were not purchase money loans, and so not subject to the purchase money exemption to MLA regulations.

In 2020, the DOD rescinded the portions of its 2017 guidance that made this distinction. This rescission was relatively universally interpreted to mean that the MLA had reverted to the prevailing interpretation—that a purchase money loan did include "hybrid" loans that also financed GAP insurance, and consequently, the purchase money exemption remained for purchase loans that also financed products such as GAP.

In early 2022, interpretations in this area were imperiled when the DOD, DOJ, and CFPB filed an "amicus curiae brief" (a supplemental commentary from a non-party to the litigation at hand in an appeal) in a case before the Fourth Circuit Court of Appeals[4] arguing that a hybrid loan did not meet the MLA's purchase money loan exception. This is not a law, but it is an indication of the government's view on the meaning of the MLA regulations. Accordingly, these interpretations could be revived either by the Fourth Circuit, or in subsequent rulemaking from the DOD.

### B. California Developments – SB1311: Veterans Protections

Under existing California law, certain military servicemembers are eligible for various consumer related benefits, including, but not limited to, interest rate reductions and payment deferrals on certain loan types during times of military service. Federal laws, such as the MLA provide separate protections for servicemembers that may be applied in combination with those benefits offered at the state law level. SB1311, the Military and Veteran Consumer Protection Act of 2022 expands California law with provisions that impact the enforcement of existing state and federal consumer protections for servicemembers.

One of the main elements of SB1311 is that it voids any security interest in a motor vehicle if the underlying loan is (1) exempt from the MLA and (2) the loan finances credit insurance products or credit-related ancillary products. This appears to be an attempt to close a potential loophole in the interpretation of the MLA mentioned above, where courts are currently attempting to determine the scope of the MLA exception for vehicle purchase money loans that also finance the purchase of GAP. Under SB1311, if a covered member, as defined in the MLA (this definition does <u>not</u> include dependents of covered servicemembers), is the borrower under a vehicle finance transaction, and the transaction is otherwise exempt from the MLA (for example, a purchase money loan is exempt, while a refinance is not exempt under the MLA), that transaction cannot also finance credit insurance products or credit-related ancillary products, or else the security interest in the vehicle is void and the obligation can only be enforceable against the borrower on an unsecured basis. Given this potential significant result (loss of the security

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[4] Davidson v. United Auto Credit Corp., *available at* https://files.consumerfinance.gov/f/documents/cfpb_davidson-v-united-auto-credit-corp_amicus-brief_2022-01.pdf.

interest in the vehicle), lenders will have to determine whether they will continue to allow for vehicle purchase loans to also finance credit-related ancillary products such as GAP.

In addition, SB1311 limits the ability of financial institutions to collect payments on mortgage obligations that have been deferred pursuant to the California's Military and Veterans Code, which permits servicemembers to defer payments during their active-duty service (or petition courts for longer deferral periods). SB1311 provides that such deferred mortgage payments are only due and payable when the property securing the loan is sold, or at the occurrence of the specific events set forth in the loan documents that would otherwise permit the financial institution to accelerate the loan.

The final important piece of SB1311 is the addition of an additional statutory penalty for violations of California's Unfair Competition Law ("UCL") with respect to servicemembers. Currently, violations of the UCL can subject the offender to liability of up to $2,500 per violation. Under SB1311, if a violation of the UCL is perpetrated against a servicemember, the offender may be liable for an additional civil penalty of up to $2,500. It would not be unreasonable to assume that with the servicemember protections added by SB1311, there will be an increased scrutiny placed on businesses' interactions with servicemembers and therefore increased potential exposure to liability for violations of the UCL.

Given the substantial potential liability financial institutions may be exposed to as a result of the protections added by SB1311, your financial institution should take immediate steps to ensure that it is not financing GAP or other credit insurance or ancillary related products on loans made to covered members that fall within an exemption to the MLA. Financial institutions should also reach out to their indirect lending partners to confirm their ability to comply with SB1311's new requirements, as we understand that auto dealers may not be on track to comply. We encourage you to reach out to us for additional information about how SB1311 may impact your auto lending processes.

## VII. "JUNK" FEES

As we look back on 2022, it becomes very clear that regulators collectively determined to take a hard stance on a number of fees charged by financial institutions, as well as other businesses.[5] The regulators focused on fees that, in regulatory eyes, were a source of surprise for consumers, were often not able to be avoided, are not itemized or included in original quotes or estimates, or impede competition by being obscured from competitive shopping—so-called "Junk Fees." For purposes of this section, we discuss "junk fees" as including the following, by reference to CFPB and other regulatory commentaries: surprise overdraft fees, return deposited item fees, pay-to-pay fees, and periodic statement fees.

From a historical perspective, these shifts may not be surprising. Many of these fees were developed in the mid-2000's, as low interest rates put pressure on net interest margin. Financial institution had trouble making money. Now, large banks have scale such that they are taking advantage of increased margins, and are able to step back or give ground on fights in these areas.

[5] CFPB commentary includes here "service charges" and "resort fees" in the travel and hospitality industry, as well as a number of fees in financial services.

At the same time, lobbying from consumer groups has continued to gain traction, and the CFPB continues its mission under a Democratic administration more friendly to consumer interests.

Financial institutions should expect more regulatory oversight and more litigation regarding junk fees as plaintiffs may seek to take advantage of the current environment surrounding these fees. Notably, the CFPB launched an initiative in January of 2022 to scrutinize back-end junk fees, which garnered a lot of interest and led to tens of thousands of people responding with stories about "unnecessary" fees from financial institutions. Since then, the CFPB has taken action to attempt to constrain these fees and, given the attention in this area, we anticipate that the CFPB and other legislatures and regulators will continue their aggressive efforts into the new year and beyond.

## A. CFPB Areas of Emphasis on Fees

Please see the following breakdown and analysis of the various "junk" fees that were a point of emphasis this year.

### Surprise Overdraft Fees

Surprise overdraft fees appear to be the biggest point of emphasis for regulators regarding junk fees. The CFPB issued a Circular in October of 2022 ("Circular"), which highlighted that when financial institutions charge surprise overdraft fees, sometimes as much as $36, they may be breaking the law. This Circular came on the heels of a consent order issued by the CFPB against Regions Bank in September 2022 ("Regions Bank Consent Order"), which addressed surprise overdraft fees. In addition, the CFPB recently issued another consent order against Wells Fargo Bank on December 20, 2022 ("Wells Fargo Consent Order"), which, among others, also took issue with Wells Fargo's surprise overdraft fee practices. Between the Circular, the Regions Bank Consent Order, and the Wells Fargo Consent Order (the "Regions Bank Consent Order" and "Wells Fargo Consent Order" are collectively referred to hereafter as the "Consent Orders"), the CFPB cemented its position on surprise overdraft fees, and specifically, "Authorize-Positive, Settle-Negative Overdraft Fees" or "APSN Overdraft Fees".

Importantly, between the Circular and the Consent Orders, the CFPB has deemed the practice of charging overdraft fees on debit-card purchases and ATM withdrawals even though consumers had sufficient funds when a financial institution authorized the transaction, but then the transaction later settled with an insufficient balance, i.e., APSN Overdraft Fees, to be unfair and abusive practices in violation of the Consumer Financial Protection Act (i.e., "UDAAP Violations").

Notably, neither the Circular nor the Consent Orders mentioned an institution's disclosures as to its practices related to charging APSN Overdraft Fees. Instead, the Circular and the Consent Orders focused on the practice of charging said fees, in-of-itself, which, the CFPB has stated is a complex practice that consumers did not understand or control and were contrary to consumers' reasonable expectations. In other words, it appears that even if a financial institution discloses its APSN Overdraft Fee practices, that may not be sufficient to avoid regulatory exposure. In fact, the CFPB in the Consent Orders specially banned Regions Bank and Wells Fargo from charging

overdraft fees for deposit accounts when the consumer had available funds at the time of a purchase or other debit transaction, but then subsequently had a negative balance once the transaction settled (i.e. APSN Overdraft Fee). The CFPB even noted in the Wells Fargo Consent Order that "[s]urprise overdraft fees have been a recurring issue for consumers who can neither reasonably anticipate nor take steps to avoid them."

In short, the Circular and the Consent Orders have essentially banned the practice of charging APSN Overdraft Fees and financial institutions should take heed. Financial institutions that continue to charge APSN Overdraft Fees risk regulatory scrutiny and potential liability exposure for UDAAP violations, among other potential claims. As a result, financial institutions should revisit their overdraft practices and consider eliminating APSN Overdraft Fees, if applicable, in line with the CFPB's recent guidance and enforcement actions discussed herein. Financial institutions should also alert their software vendors that provide overdraft services about the recent Circular and Consent Orders and ensure that these vendors are complying with the financial institution's overdraft policies and procedures.

As to the future of overdraft fees, as a whole, we anticipate further regulation and limits placed on these fees. Notably, the U.S. House Committee on Financial Services recently voted to advance the Overdraft Protection Act (H.R. 4277), which seeks to limit, among others, the number of fees financial institutions could charge per month and per year and would also require that overdraft fees be reasonable and proportional to the cost of processing the related transactions. In short, H.R. 4277 would establish a legal framework and consumer protection laws related to overdraft practices. Although H.R. 4277 is still working its way through the legislative process, it appears to be an indication of where the law is headed regarding limiting overdraft fee practices. Based on the foregoing, financial institutions should proceed with caution and prepare for legal and regulatory changes that seek to restrict and/or limit overdraft fee practices.

<u>Return Deposited Item Fees</u>

In October of 2022, the CFPB issued a bulletin ("Bulletin") regarding unfair returned deposited item ("RDI") fee assessment practices. The Bulletin appears to be in line with the recent general sentiment of regulators, who appear to be increasingly disfavoring junk fees as discussed herein. The CFPB stated in the Bulletin that blanket policies of charging RDI fees for all returned transactions irrespective of the circumstances or patterns of behavior on the account are likely unfair under the Consumer Financial Protection Act ("CFPA"). Admittedly, this is a vague statement that could have a wide-ranging effect on financial institutions and their RDI fee assessment practices and may even come down to judgment calls.

Importantly, the Bulletin focuses on financial institutions' policies that broadly impose RDI fees even under circumstances where consumers do not know whether checks will be returned; for example, a consumer would normally be unaware of and have little to no control over whether a check originator has funds in their account, will issue a stop payment instruction, or has closed the account. It is under these circumstances (where a consumer does not know whether a check will be returned) that the CFPB took issue with charging RDI fees; therefore, even having clear and robust procedures in place allowing for these circumstances would not protect financial

institutions from legal or regulatory risks related to these practices that the CFPB have deemed unfair. In short, financial institutions will need to have clearly and narrowly tailored RDI fee policies and procedures in place that do not allow RDI fees to be charged where a consumer does not know and cannot reasonably be expected to know whether a check will be returned.

However, the CFPB did specifically state that it is unlikely that a financial institution will violate the prohibition on unfair practices under the CFPA if the method in which RDI fees are assessed is tailored to only charge consumers who could reasonably avoid the injury, such as repeatedly depositing bad checks from the same originator or depositing checks that are unsigned. The CFPB also implied that charging RDI fees where there is a pattern indicative of fraud would also appear not to violate the CFPA. In addition, the collection of fees in circumstances where the consumer anticipates that a check will be returned but deposits it anyway, such as where a consumer knowingly (or even negligently) deposits a counterfeit check, would not be considered an unfair practice. Although these circumstances were specifically provided for by the CFPB, there may be other instances where financial institutions would be able to charge an RDI fee; however, financial institutions must always be mindful of whether the assessed fee is tailored to only charge consumers who could reasonably avoid the fee being charged, for example, where the consumer knew a check would be returned.

With that, please note that the Bulletin does not completely ban the ability to assess RDI fees but does place boundaries and limitations on such assessment as discussed herein, and therefore, financial institutions must proceed with caution. As noted by the CFPB, there is a substantial risk of violating the prohibition on unfair acts or practices concerning blanket policies of charging RDI fees. As such, our general recommendation based on the Bulletin would be as follows: if financial institutions wish to continue their RDI fee assessment practices, we would recommend that they first take a look at their policies and processes and related disclosures and fee schedules. Upon doing so, financial institutions that decide they want to continue with their RDI fee assessment practices, which inevitably will come with some compliance risks given the current regulatory environment and the CFPB's broad authority under the CFPA, we would recommend that these financial institutions update their RDI fee assessment policies and procedures and disclosures, including any related fee schedules, to be more robust and narrowly tailored to the specific circumstances and patterns of behavior they seek to charge these fees, so long as the fees are justified given the circumstances/pattern of behavior (as discussed herein). We believe the more tailored and specific the financial institution's policies and procedures are regarding when and how these RDI fees are charged, with a focus on whether the member/customer could reasonably anticipate the fee being charged, the better off the financial institution will be from a compliance exposure mitigation standpoint. Needless to say, the changes in RDI fee practices must also likely be supported by changes in each financial institution's systems to ensure that they apply fees consistently with the CFPB Bulletin.

With that, and given the CFPB's broad interpretation, some fee assessment practices may come down to a judgment call. Nonetheless, revising disclosures and fee schedules to align with the financial institution's updated RDI policies and procedures, if any, will be important, and a more itemized approach to each RDI fee category may likely strengthen a financial institution's argument against unfair practices. Of course, the experts here at SW&M are happy to further assist financial institutions in analyzing the risk related to specific RDI fee practices.

Pay-to-Pay Fees

The CFPB issued an advisory opinion on pay-to-pay fees in June of 2022 in the context of the Fair Debt Collection Practices Act ("FDCPA"). Said advisory opinion concluded, in pertinent part:

- The collection of *any* fee, which includes pay-to-pay fees is prohibited unless the fee amount is expressly stated in the underlying agreement or affirmatively permitted by law.
- Please note that silence in the law does not constitute "permitted by law." We are not aware of any state law, California or otherwise, that expressly permits pay-to-pay fees.
- Debt collectors violate the FDCPA when using payment processors who charge unauthorized fees and remit to the debt collectors any amount in connection with the unauthorized fee.
- Debt collectors cannot separately contract for the payment of pay-to-pay fees. For instance, the servicer and the borrower agreeing on the phone to pay the fee does not constitute a separate contract. The fee must be disclosed in the original contract. Therefore, a change in terms agreement to incorporate the fee to the loan agreement is not possible.

Furthermore, the advisory opinion is written in such a way that it can be potentially extrapolated to any fee that is collected from the borrower (i.e., repossession fees, etc.) that is not expressly disclosed in the loan agreement.

Importantly, this CFPB advisory opinion was based on the FDCPA's prohibition against the collection of any amount—including any interest, fee, charge or expense incidental to the principal obligation, unless such amount is expressly authorized by the agreement creating the debt (i.e., the original agreement) or permitted by law.[6] The impermissibility to collect pay-to-pay fees in the course of debt collection unless otherwise expressly authorized by the underlying agreement or permitted by law was also confirmed by the *Alexander v. Carrington Mortg. Servs., LLC* case out of the Fourth Circuit, which came before the CFPB advisory opinion.[7] In short, the *Alexander* court held that the defendant violated the Maryland Consumer Debt Collection Act ("MCDCA") and the Maryland Consumer Protection Act by charging $5 convenience fees to borrowers who paid monthly mortgage bills online or by phone. The Fourth Circuit reasoned, in pertinent part, that the defendant was a collector who charged an amount that was not expressly authorized by the agreement creating the debt or permitted by law, thereby violating the MCDCA. Interestingly, the defendant conceded that the agreements creating the debt did not expressly authorize the convenience fees, although it is very much unsettled as to what is considered "expressly authorized by the agreement creating the debt" per 15 U.S.C. § 1692f(1).

The *Alexander* case came out of the Fourth Circuit and is, therefore, not controlling in any other circuit, including the Ninth Circuit; however, it will likely be used as persuasive authority, especially here in California given the similarities between the Maryland Consumer Debt Collection Act and the California Rosenthal Debt Collection Act, both of which incorporate

[6] 15 U.S.C. § 1692f(1).
[7] Alexander v. Carrington Mortg. Servs., LLC, 23 F.4th 370, 372 (U.S. 4th Cir. 2022).

many of the provisions of the FDCPA and broaden the definition of a debt collector to include creditors. Further, we suspect the plaintiffs' bar will use the reasoning behind the *Alexander* case in conjunction with the aforementioned CFPB advisory opinion on pay-to-pay fees in bringing new claims.

Having said that, we understand that creditors are not considered debt collectors subject to the provisions of the FDCPA, and as such, unless a particular state law broadens the definition of a debt collector to include creditors as is the case in some states like Maryland and California, then creditors would not be bound to the FDCPA requirements discussed herein. However, please note that even if a creditor may not be subject to the provisions of the FDCPA, there is also the potential risk of violating UDAAP laws and state equivalent laws (see discussion below regarding UDAAP and pay-to-pay fees).

In sum, the *Alexander* case and the CFPB's advisory opinion discussed herein invite litigation in this area and create uncertainty for financial institutions. Our general recommendation in light of the aforementioned is for creditors to consider stopping charging these pay-to-pay fees when collecting debts unless provided for in the underlying agreement, and certainly, stop charging these fees in states that incorporate the FDCPA and broaden the definition of a debt collector to include creditors (such as Maryland and California), unless said fees are provided for in the underlying agreement.

On a separate note, unrelated to the debt collection world but related to pay-to-pay fees, the CFPB found in its Supervisory Highlights from the first half of 2022 that mortgage servicers violated federal law by charging phone payment fees even though consumers were not made aware of these pay-by-phone fees. Specifically, the CFPB took issue with the fact that the pay-to-pay fees were being charged by the servicers without full and proper disclosure, and thus, a violation of the CFPA (i.e., UDAAP violation). In sum, the CFPB examiners found that the servicers engaged in abusive acts or practices by charging phone payment fees when consumers were unaware of the fees, thus taking unreasonable advantage of consumers' lack of understanding of the fees.

Having said that, the guidance from the Supervisory Highlight is much different from the CFPB's guidance on pay-to-pay fees in relation to the FDCPA, as the FDCPA already expressly prohibits these fees unless provided for in the underlying agreement or permitted by law. As a result, the Supervisory highlight may signal that the CFPB may try to broaden its reach outside of the debt collection world to regulate these pay-to-pay fees based on its broad authority under UDAAP. As such, financial institutions must ensure that not only are they abiding by applicable debt collection laws related to pay-to pay fees as discussed herein, but must also ensure that they are properly, accurately, and clearly disclosing these pay-to-pay fees, as applicable.

<u>Periodic Statement Fees</u>

Periodic statement fees are receiving more scrutiny, and as such, financial institutions should tread carefully. For example, a class action lawsuit was filed in New York alleging that charging a statement fee was an unfair business practice in violation of New York state law.[8] In *Manship*,

[8] *Manship v. T.D Bank, N.*A., 2021 U.S. Dist. LEXIS 48909, at *30 (N.D.N.Y. Mar. 16, 2021).

the plaintiff alleged that the defendant charged her a $1.00 monthly fee to receive her account statements in paper form in violation of N.Y. General Business Law § 399-zzz, which prohibits the charging of paper statement fees in connection with billing statements in certain circumstances. The court in *Manship* ultimately dismissed the complaint but financial institutions must remain mindful of further regulatory guidance/class action lawsuits in this regard.

Further, please note that while federal regulations do not explicitly state that it is illegal to charge for paper statements, the National Consumer Law Center ("NCLC") in its March 2016 publication titled "Paper Statements: An Important Consumer Protection" argues that financial institutions should not, and legally cannot, charge a fee for providing something they are mandated by law to provide. Although the NCLC is not a governing body in charge of regulating financial institutions, it is possible that regulators may look to this guidance in their efforts to curtail junk fees.

Takeaway

In sum, regulators are beginning to take a hardline approach regarding "junk" fees. One of the takeaways that we are seeing in reviewing the bigger picture related to junk fee regulation is that regulators appear to be increasingly attempting to crack down on fees where financial institutions are profiting on arbitrary fees, as opposed to fees that bare a relationship/nexus to the actual cost of the service being provided. Based on the foregoing, we anticipate that there will be more legal and regulatory limitations that will attempt to place a framework around these backend fees in an effort to ensure that they are reasonable and proportional to the cost of processing the related transactions. Of course, the experts at SW&M will continue to monitor the changing landscape regarding fees and are always happy to assist financial institutions in navigating through the uncertainty as we see more guidance on the issues discussed herein.

### B. California SB1415: Annual Report of Overdraft Fees

SB1415 requires California state-chartered banks and credit unions to notify the DFPI annually of revenue they received from fees on nonsufficient funds ("NSF") and overdraft charges during the calendar year.[9]

Under the new law, the annual reports must include both the dollar amount of revenue from overdraft and NSF fees and also must provide the percentage of that revenue as a proportion of the bank/credit union's net income. Said reports are due to the DFPI on or before March 1 of every year so the DFPI can publish the information on its website by March 31. Please further note that the DFPI is currently developing a data collection and reporting process to help the covered financial institutions comply with the new reporting requirements.

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[9] Please see the following pertinent definitions, as outlined in SB1415:

- "Nonsufficient funds fees" means fees resulting from the initiation of a transaction that exceeds the customer's account balance if the customer's bank or credit union declines to make the payment.
- "Overdraft fees" means fees resulting from the processing of a debit transaction that exceeds a customer's account balance.

With that, it appears that the California legislature, through SB1415, is relying on the framework of similar reporting requirements for big banks related to NSF and overdraft fees. In this regard, and since 2015, the Federal Financial Institutions Examination Council has required banks with more than $1 billion in assets to report revenue from overdraft-related service charges, a category that also includes NSF fees. Such reporting exposed the disproportionate effects and costs of NSF and overdraft fees to low-income families and minorities and brought to light the profitability of these fees. In this same vein, it appears SB1415 seeks to bring to light the effects of these fee practices, as specific to California banks and credit unions, which may lead to further legislation. In the meantime, this new law appears to be an initial attempt by the legislature to curtail overdraft and NSF fee practices, which have also been a focus of regulators as of late, with some regulators deeming certain practices related thereto as unfair and abusive.

### C. Additional Legislative Attentions

While we do not normally discuss here pending legislation, we do note that the U.S. House Committee on Financial Services recently voted to advance the Overdraft Protection Act (H.R. 4277), which seeks to limit, among others, the number of fees financial institutions could charge per month and per year and would also require that overdraft fees be reasonable and proportional to the cost of processing the related transactions. In short, H.R. 4277 would establish a legal framework and consumer protection laws related to overdraft practices. Although H.R. 4277 is still working its way from the legislative process, it appears to be an indication of where the law is headed regarding limiting overdraft and NSF fee practices.

Based on the foregoing, financial institutions should proceed with caution and prepare for legal and regulatory changes that seek to restrict and/or limit overdraft and NSF fee practices. To stay ahead of the game, financial institutions should become very familiar with their respective overdraft and NSF fee practices and the related impacts, including financial impacts.

## VIII. STATE LAWS AND DEVELOPMENTS THAT APPLY TO FINANCIAL INSTITUTIONS WITH CALIFORNIA OPERATIONS

Below, unless otherwise stated, bills go into effect as of January 1, 2023.

### A. California Employment Updates

A number of new laws in California related to employment practices go into effect January 1, 2023 or have already become effective during 2022. Financial institutions should ensure that they are up to speed with these changes and prospective developments.

#### 1. SB114 and AB152 and AB1751: Extended COVID-19 Protections

When the pandemic began in 2020, the State enacted various measures to protect employees and their families from the financial impact of COVID-19. In February 2022, in response to the rapid spread of the COIVD-19 Omicron variant, the Governor signed Senate Bill 114 which extended COVID-19 supplemental paid sick leave through September 30, 2022. COVID-19

Supplemental Paid Sick Leave ("CSPSL") was originally implemented by Senate Bill 95 in September 2020 and set to expire on September 30, 2021. CSPSL is mandated for employers with more than 25 employees.[10] Senate Bill 114 earlier this year extended it retroactively from January 1, 2022 and revised some elements of its application. Just before CSPSL expired in September of this year, the Governor signed AB152 extending CSPSL through December 31, 2022. In addition to extending CSPSL, the Governor also signed AB1751 which extended another COVD-19 protection that allowed employees to more easily claim workers' compensation for contracting the virus in the workplace.

SB114 Revisions to CSPSL

By way of background, CSPSL continues to apply to employers with more than 25 employees. SB114 also made no changes to the conditions that entitled a covered employee to request CSPSL. A covered employee is entitled to CSPSL when:

- The employee is subject to quarantine or isolation as defined by the state or local health agency or the CDC;
- The employee is advised by a health care provider to self-quarantine;
- The employee has an appointment for the vaccine or booster;
- The employee is experiencing COVID-19 symptoms and is seeking medical diagnosis, or is experiencing symptoms from the vaccine or booster and is unable to work; or
- The employee is caring for a family member who is quarantined or isolated of for a child whose school of daycare is closed due to COVID-19.

Rather, SB114 revised the amount of leave to which an employee is entitled under certain conditions, created two different types of CSPSL, and authorized the employer to request certain documentation from the employee in order to be granted CSPSL.

Prior to SB114, employees were entitled to up to 80 hours of CSPSL. The bill, however, split CSPSL into two types of permissible leave for up to 40 hours each. The first category of leave largely applied to the same conditions listed above except the employee can only take up to 40 hours instead of 80 hours as under the original bill, SB95. The one exception in the first category of leave that differed from SB95 was the employer's authority to limit CSPSL for symptoms from the vaccine or booster to only 24 hours or three days unless the employee produces documentation from a health care provider stating that the employee's symptoms require more than three days of leave. The second category of leave requires an employee, or the family member for whom the employee provides care, tests positive for COVID-19. Employers are authorized to require proof of a positive COVID-19 test before granting the employee an additional 40 hours of CSPSL. Further, an employer can require the employee to take a second test on or after five days after the initial positive test. The employer would be required to cover any costs associated with the second test.

SB114 also provided a formula to calculate how much CSPSL leave a part-time employee could receive. For part-time employees who work a regular weekly schedule, the employee would be

[10] Cal. Labor Code § 248.2(a)(2).

entitled to the same number of hours for CSPSL. If, however, the part-time employee works a variable schedule, the entitlement is based on the average number of hours the employee worked in the preceding six months. The total amount available to the part-time employee would apply to both categories of CSPSL. For example, a part-time employee who regularly works 25 hours per week would be entitled to 25 hours of CSPSL for any of the listed conditions and would be entitled to an additional 25 hours if the employee tests positive for COVID-19.

This bill also made revisions to the rate of pay for CSPSL. Previously, employers were required to pay at the highest rate from various calculations. Under SB114, the rate of pay is determined on a formula similar to those used for regular paid sick leave.[11] Maximum compensation remains at $511 per day or $5,110 in total.

AB152 Extension

AB152 had the primary effect of extending SB114 and putting forth further clarifications. In particular: (i) the expiration date was extended to December 31, 2022; and (ii) an employer may require an employee to take a third COVID-19 test after the employee tested positive on the first two tests. With regard to the additional testing, employers must provide the testing at no cost to the employee.

While CSPSL may expire on December 31, 2022 without extension, employers are reminded that SB114 and AB152 authorize employees who previously took unpaid leave due to COVID-19 to request payment for those dates between January 1, 2022 and December 31, 2022. The law does require the employer to provide retroactive payment upon request for leave that would have otherwise been paid under CSPSL. Similarly, employees are authorized to request credit for sick leave taken within the retroactive period if it was COVID-19 related. The employer is permitted to require documentation from the employee requesting retroactive pay. In the event that an employee begins a leave under CSPSL at the time that the law expires, the employee is permitted to take the entire allowable amount of CSPSL. Finally, employers are reminded that it may not require the employee to exhaust other types of leave before the employee can use CSPSL.

AB1751 Extension and Expansion to Additional First Responders

Also, in response to the pandemic in 2020, Senate Bill 1159 was passed with the intention of facilitating the provision of workers' compensation benefits to employees who contracted the virus. SB1159 created a rebuttable presumption that an employee's illness related to COVID-19 is an occupational injury and, therefore, is compensable by workers' compensation benefits.[12] The law was set to expire and be repealed on January 1, 2023. AB1751, however, extended the law for another year and expanded one subsection to include certain employees (firefighters) who were not previously listed in the original statute. The Legislature noted that, while COVID-19 is winding down and new cases have decreased in frequency, it remains a public health crisis, especially for first responders whose exposure and risk for contracting the virus is much higher. Therefore, the need for easier access to workers' compensation benefits is still necessary. With the passage of AB1751, the presumption that COVID-19 illnesses and deaths "arise out of and in

[11] Cal. Labor Code § 246(l).
[12] Cal. Labor Code §§ 3212.86, 3212.87, 3212.88.

the course of" employment under certain conditions, such as an office outbreak, remains in effect until January 1, 2024.

2. AB2693: Employer COVID-19 Exposure Notifications

AB2693 extends certain requirements for employers to post notifications of COVID-19 exposures. Requirements that would otherwise have expired on January 1, 2023 were extended to January 1, 2024.

In 2020, with the onset of the COVID-19 pandemic, the original notification system (AB685) was passed to provide guidelines and requirements for employers to safeguard from spreading infections and outbreaks. Employers were required to notify employees of exposure to the virus in an effort to aid in stopping the spread of the virus and its variants.

In addition to requiring employers to distribute notifications, the existing law also authorized the Division of Occupational Safety and Health ("Cal/OSHA") to restrict access to a workplace or shut down an operation where the division determined an imminent hazard existed. AB2693 extended Cal/OSHA's authority to prohibit entry into a workplace until January 1, 2024.[13]

AB2693 did not only extend the expiration of these requirements, but also revised employers' notification and reporting requirements. The new version strikes provisions that required employers provide written notifications to employees of exposure to COVID-19. In lieu of the stricken requirements to notify employees in writing, employers may now post notices around the customary areas of the workplace where notices are posted to alert employees to possible exposure. These notices must contain specific information such as the dates on which a confirmed case of COVID-19 was on the premises within the infectious period, the location of the exposures (e.g. department, floor, building, etc.), and information regarding COVID-19 benefits. The notices must remain posted for at least fifteen (15) calendar days and must be posted in English and in the language understood by the majority of the employees. AB2693 also permits employers to publish the notification on an employee portal or to communicate with the exposed employees via email or text message if such manner of communication is normally used by the employer. Further, employers are no longer required to notify the local public health agency in the jurisdiction of the worksite when the number of cases meets the definition of an outbreak.

While the threat of COVID-19 continues to decrease, employers are reminded to stay abreast of the continuing requirements for notifications of exposure in the workplace and of Cal/OSHA's authority to declare a workplace unsafe due to COVID-19 exposure and prohibit entry until imminent hazards are resolved.

3. AB1041: CFRA Law Expanded to Care for "Designated Persons"

This bill expands the rights of an employee to take unpaid leave under the California Family Rights Act ("CFRA"), a law which provides California workers employed by an employer with 5

[13] Labor Code §6325(b)

or more employees with Paid Sick Leave ("PSL") rights. Previously, employees were permitted PSL for the care of family members. Under AB1041, employees will now be entitled to take unpaid leave to care for "designated persons." A designated person is defined as any individual related by blood or whose association with the employee is the equivalent of a family relationship. The designated person does not need to be identified at any time preceding the employee's request for the leave.[14] Put simply, employers cannot require an employee to identify or provide a list of predesignated persons. The employer may, however, limit the employee to one designated person per 12-month period for family care and medical leave.

An employer may not <u>require</u> an employee to use their paid sick leave for the care of designated person with serious medical condition.[15] However, the employee and employer may mutually agree to use the employee's paid sick leave, rather than taking all time unpaid. Certification of the designated person's serious health condition may still be required for support by the employer. The Healthy Workplaces, Health Families Act of 2014 was also amended by AB1041 to include a designated person as a "family member," for whom employees may take paid sick leave to provide care.[16]

The purpose of this bill is to address the growing number of households in California that do not reflect the traditional nuclear family structure (parents and their biological children). The state legislature relied on statistics from the 2020 U.S. Census Bureau that showed only 18.4% of American households follow the traditional nuclear family structure. Within the remaining 81.6% of households that contained "family" members who were either members of extended, multigenerational families related by blood, such as a grandparent, aunt/uncle, or cousin, or chosen family members with no blood relation, which are particularly relevant in the LGBTQI+ communities. In its analysis, the state legislature noted that individuals identifying with the LGBTQI+ community have a higher likelihood to have strained relationships with blood relatives and, consequently, form close bonds akin to those within a traditional family structure. It also commented that areas with housing shortages, high costs of living, and where new immigrants live with relatives are more likely to contain multigenerational households. California was identified as a state with more multigenerational households than the national average. In sum, as the law existed prior to AB1041, a minority of households were protected. After the passage of AB1041, proponents argue that the law now more closely reflects the household demographics most common in the state.

Policies will need to be adjusted to reflect the designated person. Address eligibility requirements are unchanged (12 months employment with 1250 hours in that year). There will likely be new posters and guidelines posted by California Civil Rights Department (formerly California Department of Fair Employment and Housing) (the "CRD").

4. <u>AB1601: Employment Protections for Call Centers</u>

Employers with call center (or similar) operations will need to consider additional consequences for any decisions to relocate any operations to a foreign country. AB1601 requires particular

[14] Cal. Gov. Code §12945.2(b)(2).
[15] Cal. Gov. Code §12945.2(d).
[16] Cal. Labor Code §245.59(a)(8).

notifications at least sixty (60) days ahead of a call center relocation. The bill essentially expands the reach of the Cal-WARN[17] to a specific group of workers—call center employees.

Definition of a "Call Center"

First, an employer will need to determine whether the new law is applicable to its operations. AB1601 defines "call centers" rather broadly. A "call center" is defined as, "a facility or other operation where employees, as their primary function, receive telephone calls or other electronic communication for the purpose of providing customer service or other related functions."[18] While many financial institutions may not operate call centers in a traditional sense, the law may still be applicable to a branch where the employees' primary functions will fit within the statute's definition of a call center. Note, however, that the law would not appear to apply where employees engaged in call reception or other customer service are already remote workers. Considering that operations in post-COVID business have largely moved to electronic forms of communication, branches that typically handled face-to-face customer service might now operate primarily with phone calls and other forms of electronic communication in providing customer service. Per AB1601, a branch with such operations may soon require the same notifications that are required under Cal-WARN if it decides to relocate.

Definition of "Relocation"

The next question would be whether the anticipated move constitutes a relocation per the statute. Generally, Cal-WARN considers a relocation as "the removal of all or *substantially all* of the industrial or commercial operations in a covered establishment to a different location 100 miles or more away."[19] The revised law applies a different definition to the relocation of call centers. The relocation of a call center entails less than "substantially all" of the operations moved to a different location when the new location is outside of the country; rather, the Cal-WARN requirements are applicable if the employer intends to move *any* of the following to a foreign country:

- the entire call center;
- one or more of the facilities or operating units within a call center comprising at least 30 percent of the call center's total average volume; or
- substantially similar operations.[20]

While this definition makes its application to financial institutions unlikely, it is an additional consideration in reorganization plans.

Consequences for Relocating a Call Center

In the event that a financial institution decides to relocate its call center or other operations similar to the functions of a call center to a foreign country, the consequences are more than just the duty to notify the affected employees and relevant government agencies. An employer who

[17] California Worker Adjustment and Retraining Act. See Labor Code §1401 *et seq.*
[18] Cal. Labor Code §1409(b)(1), effective January 1, 2023.
[19] Cal. Labor Code §1400.5(e).
[20] Cal. Labor Code §1409(b)(3), effective January 1, 2023.

fails to issue the required notifications of the relocation of a call center faces the same liability to the affected employees for back pay, cost of benefits, and attorneys' fees, as well as civil penalties from the Labor Commissioner. In addition, the employer becomes ineligible to receive state grants, state-guaranteed loans, and state tax credits for five years.[21] The state legislature reasoned in its analysis of the bill that companies who move 30 percent or more of their call center operations to another country negatively impact Californian workers and communities. Accordingly, the legislature determined that such companies that engage in offshoring practices should not have the privilege of utilizing California communities' tax dollars.

5. AB1854: Unemployment Insurance and Work-Sharing Plans

In response to the COVID-19 pandemic and the economic impact on business, in 2020, the California legislature passed measures that would permit an alternative, streamlined process for employers to have work sharing programs approved by the state's Employment Development Department ("EDD"). Initially, the new process only applied to work sharing applications submitted to EDD between September 15, 2020 and September 1, 2023. Accordingly, the new electronic process would expire and the traditional process with paper applications via postal mail would resume after September 2023. AB1854 proposed to extend the electronic submission process for work sharing program applications indefinitely. The bill was signed by Governor Newsom on July 19, 2022, thereby making the online process permanent.[22]

Having an online process allows employers to take advantage of work share programs without the delay of the traditional process by mail. By way of background, the work sharing program allows for businesses to avoid laying off employees and, instead, offer reduced hours to the employees while the employees simultaneously collect unemployment payments from the state. The legislature's goal in extending the online process indefinitely is to encourage more employers to take advantage of the work share program option so that more employees are retained and lay-offs can be avoided. This new process has proven to relieve some of the burden from employers who file new plans or renew existing plans on an annual basis.

6. 2016's SB3 Minimum Wage Increase

Effective January 1, 2023, the minimum wage for all employers will increase to $15.50 per hour. Employers will more than 25 employees will increase from $15 in 2022 and employers with 25 employees or less will increase from $14 in 2022. SB3 from 2016 mandated annual increases in the minimum wage since 2017. Although the bill projected incremental increases up to only $15 for small employers,[23] Governor Newsom declared in May 2022 that all employers, regardless of size, would increase minimum pay to $15.50 per hour to combat the effects of inflation.

Employers should keep in mind that many county, city and local ordinances set the minimum wage higher than the state. For example, the minimum wage in Mountain View, CA will increase to $18.15 at the beginning of 2023. Other cities such as Cupertino, Emeryville, Los Altos, Palo Alto, Santa Clara, Sunnyvale, and West Hollywood set the minimum wage over $17.

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[21] Cal. Labor Code §1411(a), effective January 1, 2023.
[22] Cal. Unemployment Ins. Code §1279.7, effective January 1, 2023.
[23] Cal. Labor Code § 1182.12(b)(2)(F).

7. AB1949: Mandatory Bereavement Leave

While many employers have existing policies under which an employee can take a certain amount of time away from work to attend a funeral or tend to burial arrangements for a loved one, the California Family Rights Act ("CFRA") created a new category of job-protected leave to employees experiencing bereavement. In an effort to promote consistency and provide assurances for employees when they experience a death in the family, regulators proposed a law that sets minimum standards for bereavement leave. AB1949 now requires employers to grant an employee up to five (5) days of bereavement leave.[24] The days do not have to be taken consecutively, and employees may use those days at any time within three (3) months of the family member's death.

When Does the Law Apply?

Any employer with five (5) or more employees is subject to the protections of AB1949. The new law covers employees with at least thirty (30) days of service prior to the commencement of leave. The law does not specify that the employee needs to be a full-time employee, so part-time employees are presumably entitled to CFRA bereavement leave as well.

Employers are only required to grant bereavement leave to an employee upon the death of a "family member." The bill defines a family member as a spouse or a child, parent, sibling, grandparent, grandchild, domestic partner, or parent-in-law.[25] This definition includes adopted or foster children and parents, stepchildren, stepparents, and such affiliations by law. An employer's policies may permit bereavement leave for more extended family or other relations.

Paid v. Unpaid

Employers have some discretion in determining whether bereavement leave will be paid or unpaid. The law expressly states that bereavement leave shall be taken pursuant to any existing bereavement leave policy of the employer. For an existing policy that provides for less than the mandatory five (5) days, employers must now grant additional days, up to five (5) days; however, the employer is not required to compensate the employee for the additional days that exceed what is granted in the existing policy. For example, if Employer A's existing bereavement policy permits an employee to take two (2) days of paid bereavement leave, under this new law, the employer must permit the employee to take up to five (5) days of bereavement leave. Employer A would still permit two (2) of those days as paid leave and grant the additional three days as unpaid leave. In the event that an employer does not have an existing bereavement leave policy or the employer's existing policy does not grant paid bereavement leave, the entire five (5) days may be unpaid leave. In circumstances where an employee must take unpaid bereavement leave, the law permits the employee to use accrued vacation, personal time off, sick leave, or compensatory time off that is otherwise available to the employee. The language of the statute implies that the employee elects whether to exercise those options or opt for unpaid leave.

[24] Cal. Gov. Code § 12945.7, effective January 1, 2023.
[25] Cal. Gov. Code § 12945.7(a)(3), effective January 1, 2023. The definitions for child, parent, sibling, grandparent, grandchild, domestic partner, and parent-in-law refer back to Government Code § 12945.2.

Refusal Is Unlawful

Since bereavement leave is now part of the CFRA, employers do not have the right to refuse an eligible employee's request to take bereavement leave for up to five (5) days. Under the statute, refusal constitutes an unlawful employment practice and subjects the employer to the consequences under the CFRA. Employers may not retaliate, discriminate, or otherwise subject an employee to differential treatment based on the employee's exercise of their right to take bereavement leave or based on an employee's testimony in support of their own or someone else's right to take bereavement leave. An employer is permitted to request documentation of the death of the family member such as a death certificate or obituary. The employer is required to maintain the confidentiality of the employee requesting bereavement leave. Employees who believe that an employer has violated their rights to bereavement leave will have the right to file an administrative complaint with the CRD[26] and to request a right to sue letter from the agency.

Employers are advised to review existing policies for bereavement or add a bereavement policy if one does not currently exist to employee handbooks. Below is sample language for a bereavement leave policy that is in compliance with the new code:

- "Eligible employees who wish to take time off due to the death of a family member (spouse, domestic partner, parent or stepparent, child or stepchild, sibling or stepsibling, grandparent, grandchild, or in-law) may be granted up to five (5) working days off for bereavement leave. All five of the permissible days do not have to be taken consecutively, but all days must be taken within three (3) months of the date of the family member's death. [*Include statement whether days are paid or unpaid*]. Employees who wish to take time off for this purpose should notify their supervisor as soon as possible. An employee who leaves work early on the day they are notified of the death, that day will not count as bereavement leave."

- "Employees may, with their supervisor's approval, use accrued vacation time for additional time as necessary. Employees may be requested to provide documentation of the death of the family member."

The right to bereavement leave becomes effective on January 1, 2023. Employers should be prepared to properly handle bereavement requests in compliance with the new protections.

8. AB2001: Remote Employees for Financial Institutions

Under the California Financing Law,[27] a finance lender (a specific type of licensee) may not transact business at any place of business other than that named in the license unless specific circumstances are met. Based on existing law, employees of these licensees who engaged in loan transactions were not permitted by law to work from home. This issue became especially apparent during the COVID-19 pandemic when offices were forced to close and businesses created ways for employees to continue conducting business from their own homes. State

[26] California Civil Rights Department (formerly the Department of Fair Employment and Housing).
[27] Cal. Fin. Code §22000 *et seq*.

agencies, including the Department of Financial Protection and Innovation ("DFPI") issued emergency guidance that allowed for financial institutions to permit employees to work from home; however, the emergency guidance would expire when the pandemic ended. AB2001 recognizes the need for finance lenders to continue offering remote work. Note, credit unions and bank are not finance lenders; however, certain non-depository institution subsidiaries engaged in lending may be licensed as finance lenders.

In order to take advantage of this remote work authorization, finance lenders must meet certain requirements pertaining to consumer privacy.[28] AB2001 lists several requirements for a CFL-licensed employer to meet before it can authorize telework:

- Remote employees are prohibited from conducting business in-person at his/her remote location;
- Recordkeeping is prohibited at the employee's remote location unless the records are delivered and stored on an encrypted device or encrypted media;
- Remote employees are prohibited from receiving mail relating to the business at the remote location;
- Consumer personal information must be stored on an encrypted device or encrypted media;
- Employees are required to safeguard licensee records and consumer personal information;
- Employers adopt written policies and procedures that include employee data security training, security logs of remote logins, and procedures to detect suspicious activities and suspend access accordingly;
- Where employers record customer service phone calls in its regular course of business, the employers continue to record customer calls from the remote location; and
- Records and persons are made available to the commissioner at a licensed location for examination, inspection, or interview.

We note that while the specific requirements of AB2001 do not apply to depository institutions' telework policies, financial institutions should already be attending to these security and privacy best practices in their telework policies and procedures.

9. AB2068: OSHA Citations in Seven Languages

In an effort to further the mission of Cal/OSHA[29] to ensure the health and safety of all workers, including those who primarily speak a language other than English, AB2068 was proposed. Under this new bill, employers will be required to post notifications of any citations from Cal/OSHA in English and to make the same notifications available in the top seven (7) non-English languages, as indicated by the US Census Bureau.[30] According to the 2010 U.S. Census, the top seven (7) languages include Spanish, Chinese, French, Tagalog, Vietnamese, Korean, and

[28] Cal. Fin. Code § 22157.1(b), effective January 1, 2023.
[29] Cal/OSHA refers to the Division of Occupational Safety and Health within the CA Department of Industrial Relations.
[30] Cal. Labor Code § 6318(e), effective January 1, 2023.

German.[31] The bill further requires that the notifications be posted in Punjabi, even if Punjabi is not one of the top seven foreign languages identified by the Census Bureau. Each notice must indicate that the workplace was investigated, and one or more health or safety violations were discovered resulting in one or more citations. The notices are required to be posted for three working days or until the unsafe condition is corrected, whichever is longer.

Employers can be cited for failing to provide the translated notifications and, as a result, can face civil penalties for thousands of dollars.[32] While producing translated notifications in at least seven (7) additional languages will incur costs to the employer, the Legislature notes in the bill that more immigrants are employed in the industries with the highest pandemic-related deaths and emphasizes the need to improve workplace safety by ensuring that workers understand notifications of hazardous situations more effectively.

10. AB2148: Workers' Compensation Disability Payments

AB2148 proposed to extend a pilot program that allowed employers to pay workers compensation payments on a prepaid card as opposed to issuing a paper check or requiring direct deposit to the employee's personal bank account. The legislature originally passed a bill in 2018 permitting employers to utilize prepaid cards in the same manner as the Employment Development Department utilized prepaid cards to issue unemployment payments. This was a response to concerns that certain employees, typically lower-income, faced certain difficulties with accessing workers compensation payments. The pilot program was set to expire on January 1, 2023. AB2148 extended the expiration date of the program to January 1, 2024.[33] The law requires consent from the injured employee to issue funds on a prepaid card. In line with the Legislature's original intention to prevent injured workers from having to pay cash-checking fees associated with paper checks, the law provides that employees must be able to withdraw the entire balance of a prepaid card in one transaction and make point-of-sale purchases without incurring fees from the financial institution issuing the prepaid card. Further, the prepaid cards may not be linked to any form of credit, including cash advances or loans against future payments.

The original legislation also required the Commission on Health and Safety Workers' Compensation to issue a report to the Legislature about the pilot program. This reporting requirement was set to expire on January 1, 2023 and was also extended to January 1, 2024.

11. AB2188: Off-Duty Cannabis Use Protected Under FEHA

The California Fair Employment and Housing Act prohibits discrimination and harassment based on a number of listed protected characteristics and activities. AB2188 purported to protect employees from discrimination and harassment based on an additional activity—use of cannabis. Effective January 1, 2024, taking an adverse employment action against an employee based on their use of cannabis off the job and away from the workplace constitutes an unlawful

[31] https://www.census.gov/dataviz/visualizations/045/
[32] Cal. Labor Code § 6318(f), effective January 1, 2023.
[33] Cal. Labor Code § 4651(c).

employment practice under FEHA.[34] Employers will need to revise any drug testing policies and procedures to comply with the new protections for cannabis users.

Nonpsychoactive Cannabis Metabolite Testing Prohibited

AB2188 specifically prohibits employers from subjecting employees and applicants to drug tests that screen for nonpsychoactive cannabis metabolites.[35] Proponents of the bill argue that this sort of testing only reveals that an employee or applicant has consumed cannabis at some point in the recent weeks but provides no indication that the employee has arrived to work impaired or that the employee's use of cannabis on an occasion outside of the workplace poses any threat or danger to the safety of the workplace. AB2188 provides that testing for tetrahydrocannabinol ("THC") would indicate impairment, and employers should use tests that identify the presence of THC in an employee's bodily fluids rather than tests that screen for the presence of nonpsychoactive cannabis metabolites.

To comply with the new law, employers engaged in drug testing must begin to phase out any drug testing procedures that screen for the presence of nonpsychoactive cannabis metabolites and replace those tests with ones that specifically screen for the presence of THC. AB2188 is clear that the bill does not permit impairment, possession or use of cannabis on the job and that drug testing is still permissible under the statute. Employers may still discipline employees accordingly.

Exceptions

The bill provides for some exceptions. The section does not apply to employees in the building and construction industries.[36] The new section also does not apply to positions that require a federal government background investigation or security clearance. Finally, the bill does not preempt federal or state laws that require applicants or employees to be tested for controlled substances. Employees of an industry that is regulated by the U.S. Department of Transportation, for example, are subject to mandatory drug testing and this bill will not prohibit employers in those industries from conducting drug testing for cannabis and taking employment actions based on the results.

Given that this bill places such a heightened protection around off-duty cannabis use, employers are advised to review drug-testing protocols and policies to ensure compliance with the new law. For employers with offices in other states, it should be noted that California is not the first state to enact protections for employees who recreationally use cannabis. States that have enacted similar laws include Connecticut, Montana, Nevada, New Jersey, New York, and Rhode Island. Despite the fact that cannabis use remains illegal under the federal law, with the growing trend toward legalizing recreational use of cannabis, more states are likely to follow with laws protecting cannabis use.

[34] Cal. Gov. Code § 12954, effective January 1, 2024.
[35] Cal. Gov. Code § 12954(a)(2), effective January 1, 2024.
[36] Cal. Gov. Code § 12957(c), effective January 1, 2024.

12. AB2448: Pilot Program to Recognize Employers for Unruh Compliance

Beginning on or before January 1, 2025, the CRD[37] will establish a pilot program that will recognize businesses for creating safe and welcoming environments that are free from discrimination and harassment of customers.[38] The CRD will determine a business's eligibility based on the business's actions to prevent and respond to discrimination and harassment against its employees and customers. Actions that the CRD will consider include but are not limited to: (i) compliance with the Unruh Civil Rights Act; (ii) providing additional training and education for employees; (iii) informing customers of their rights and how to report discrimination or harassment; and (iv) encouraging respectful and civil behavior. Businesses that qualify for recognition under this pilot program will receive certificates that the business can display on site. Qualifying businesses will also be published on the department's website. The pilot program is set to run until January 1, 2028, when the department will evaluate the effectiveness of the program and determine whether the program caused any impact on customer behavior and incidents of discrimination and harassment at businesses. On July 1, 2028, the law is to be repealed.

The Legislature proposed this bill in an effort to address hate-motivated harassment and violence that has increased in frequency over the past few years. In both the Senate and the Assembly Analyses, statistics reflecting thousands of reports of hate incidents in California were considered. Over 25% of reported hate incidents took place at a business and the majority of the cases involved verbal harassment by another customer or passerby. The Legislature sought to address racially-motivated harassment directed toward Blacks, Asians, and Hispanics in public spaces. The certificate program would incentivize businesses to take part in addressing such behavior on its premises. It should be noted, however, that the Legislature emphasizes in the bill that businesses who receive certificates are not exempt from claims against them for violations of Unruh. Recognition under the pilot program cannot support any defense against such claims. The benefit to businesses in the pilot program is the recognition. Ideally, such recognition will gain the trust and favor of consumers; whether any such benefits would actually materialize is an open question.

13. SB1044: Employee Rights During Emergencies

Under the California Occupational Safety and Health Act, employers are required to furnish a place of employment that is safe and healthful for the employees therein.[39] Various sections of Cal/OSHA protect employees from working conditions that pose health or safety risks. In the light of the recent rise in natural disasters, such as floods and fires, and mass shootings at schools and places of business, SB1044 creates further protections for employees by prohibiting employers from taking or threatening to take an adverse employment action against an employee when, in an emergency condition, the employee refuses to report to, or leaves, the workplace or worksite within the affected area based on the employee's reasonable belief that the area is unsafe.[40] The bill also prohibits employers from preventing an employee from accessing their

[37] California Civil Rights Department (formerly the Department of Fair Employment and Housing).
[38] Cal. Civil Code § 51.17(b)(1).
[39] Cal. Labor Code § 6400(a).
[40] Cal. Labor Code § 1139, effective January 1, 2023.

mobile or other communication devices for seeking emergency assistance, assessing the safety of the situation, or communicating with a person to verify their safety.

What Constitutes an "Emergency Condition"?

Under SB1044, an emergency condition arises from either a natural disaster or a criminal act. An emergency condition refers either to conditions of disaster or extreme peril to the safety of persons or property at the workplace or worksite, or to an order to evacuate a workplace, a worksite, a worker's home, or the school of a worker's child.[41] The statute specifically excludes health pandemics as an emergency condition under this section. In the unfortunate event of an active shooter on the worksite or an employee is informed that their child's school has been evacuated due to the spread of a wildfire, an emergency condition is present and the protections of this bill are triggered. If the employee has a reasonable belief that there is a real threat of death or serious injury by entering or remaining on the premises, then the employee has the right to refuse to enter or to leave. The employer would be prohibited from taking any adverse employment actions against the employee for their decision.

Exceptions

A number of particular types of employees are exempted from these protections, including employees of a depository institution as defined in Financial Code § 1420 (including banks and credit unions).[42] SB1044, however, does apply to these types of employees where the bill requires an employee in an emergency condition to notify the employer of the emergency condition.

Although financial institution employers are not subject to the prohibitions of SB1044, these types of employers are encouraged to ensure that practices and procedures are in place in case of emergency conditions and to train employees on how to respond when emergency conditions arise. Financial institutions are reminded that other sections of Cal/OSHA still require certain actions and prohibit adverse actions against employees when it comes to their health and safety in the workplace.

14. SB1126: Mandatory Retirement Savings Program

In 2016, the CalSavers Retirement Savings Trust Act ("CalSavers") became law with the intention of creating access to a retirement savings program for employees whose employers did not offer one.[43] CalSavers originally applied to employers with five (5) or more employees. Effective January 1, 2023, the requirements of CalSavers will apply to employers with at least one (1) eligible employee.[44]

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[41] Cal. Labor Code § 1139(a)(1), effective January 1, 2023.
[42] Cal. Labor Code § 1139(b)(1)(J) and (b)(2)(C)(i), effective January 1, 2023.
[43] Government Code §100000, *et seq.*
[44] Government Code §100032(e), effective January 1, 2023.

Updated Definition of Eligible Employer

SB1126 proposed revisions to the definitions of "eligible employer." Existing law defined an eligible employer as one with five (5) or more employees and engages in a business, industry, profession, trade, or other enterprise in the state, whether for profit or not for profit. Under the revised definition, an eligible employer is defined as one with at least one (1) eligible employee, and specifically excludes sole proprietorships, self-employed individuals, and entities that do not employ any persons aside from the owners. Also, if an employer already provides a retirement savings program pursuant to § 100032(g), then the entity would be excluded from the definition of "eligible employer."

The expanded definition of eligible employers affects smaller institutions that previously did not have to comply with CalSavers. Specifically, entities with one to four employees are now required to initiate a retirement savings program arrangement to allow employee participation. Such employees were previously ineligible to access the CalSavers program, which is an individual retirement account overseen by the CalSavers Retirement Savings Board created by the CalSavers Act. As a result of SB1126's revisions, the legislature estimated that an estimated 750,000 Californians with no retirement plan will now have access to a retirement savings program. Eligible employers with less than five (5) employees will have until December 31, 2025 to implement a payroll deposit retirement savings arrangement. The CalSavers Retirement Board will have discretion to alter the timelines for compliance.

15. SB1162: Additional Measures for Pay Equity

SB1162 furthers the state's efforts to resolve issues of pay equity across various protected classes, including race, gender, and ethnicity. The new law will require employers to report more detailed pay data, to provide more transparency with pay scales, and to adhere to new record-keeping requirements.

Pay Data Report

In 2020, SB973 was passed requiring businesses with 100 or more employees to submit annual reports to the Department of Fair Employment and Housing (now called the Civil Rights Department). Similar to the required data for the federal EEO-1 annual report, SB973 required employers to provide the number of employees by race, ethnicity, and sex along specific job title categories and the number of employees by race, ethnicity and sex who earned salaries within particular pay bands.

This year, SB1162 expanded the data required to be reported and subjected employers that hire through labor contractors to the requirements as well. Going forward, private employers with 100 or more employees must submit a pay data report to the Civil Rights Department with the following information: (i) the number of employees by race, ethnicity and sex per job category; (ii) the number of employees by race, ethnicity and sex per pay band; and additionally, (iii) the median and mean hourly rate of pay for each race, ethnicity and sex per each job category.[45] The

[45] Cal. Gov. Code § 12999, effective January 1, 2023.

same pay data report requirements apply to private employers with 100 or more employees hired through labor contractors. Previously, contractors were largely unaccounted for in these pay data reports. The legislature intended to expand the collection of data to these workers.

SB1162 also extended the due date for the new pay data reports. Instead of March 31 of each year, employers will have until the second Wednesday of May to complete and submit their reports to the Civil Rights Department. Even with a 6-week extension to collect data, employers are advised to adjust timelines for collecting and aggregating the data since the newest data point for the median and mean hourly rates may be more time-consuming.

Pay Scales

Existing law requires employers to provide the pay scale of a position to an applicant upon reasonable request, which has applied any time after the employer interviews the applicant.[46] SB1162 expands the employer's responsibility to provide the pay scale for a position—as revised law, in addition to an applicant, an employer must also provide a current employee with the pay scale for the position that the employee currently holds. This grants employees the right to request pay information that reflects how the employer may be looking to pay or paying other employees in such position. Further, specifically for employers with 15 or more employees, the new law requires employers to include the pay scale for a position in any job posting. This requirement applies even where the employer utilizes third parties (e.g. recruiters, job search websites, etc.) to announce or advertise jobs. The employer is required to provide the pay scale to the third party, and the third party is required to include the pay scale in the posting.

SB1162 added that violation of this section regarding pay scales could warrant an investigation by the Labor Commissioner and/or a private civil action by an aggrieved person.[47] The law grants the Labor Commissioner the authority to order a civil penalty of $100-$10,000 per violation. A court is permitted to award injunctive relief and "any other relief that the court deems appropriate" pursuant to a private civil action. Employers with 15 or more employees are advised to ensure that all job postings contain the appropriate pay scales by the beginning of 2023. The penalties for failing to provide the pay scales either in job postings or directly to an applicant or employee upon request can be pretty severe.

Keeping Records

Employers are now required to maintain records of each job title and the wage rate history for each employee for the duration of the employment plus three (3) years[48] after employment is terminated. These records must be open to inspection by the Labor Commissioner to determine if there is a pattern of wage discrepancy.

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[46] Labor Code §432.3(c).
[47] Labor Code 432.3(d), effective January 1, 2023.
[48] Cal. Labor Code § 432.3(c)(4), effective January 1, 2023.

16. SB1477: Limits on Wage Seizures

State laws governing wage garnishment currently protect a certain amount of an employee's paycheck from garnishment so that workers are not being deprived of necessities like food, medicine, transportation costs and housing.[49] SB1477 revises the formulas used to calculate how much an employer is permitted to garnish an employee's wages.[50] Beginning in September 2023, an employee's earnings will be subject to a lesser amount of money that employers may garnish on a creditor's behalf. The maximum amount of disposable earning subject to garnishment reduces from the lesser of either 25 percent of weekly earnings or 50 percent of the amount above the state minimum hourly wage times 40, to the lesser of either 20 percent of the weekly earnings or 40 percent of the earnings above the state minimum hourly wage times 40. SB1477 also adjusted the formula for determining the maximum amounts when an employee is paid on a schedule other than weekly, e.g. daily, biweekly, semimonthly, etc.

Employer payroll departments will need to be aware of this change effective September 1, 2023 and adjust payroll systems accordingly. Employers are advised to update policies and procedures for when they are served with an earning withholding order. Failure to comply can subject the employer to civil liability for the amounts owed to the creditor.

17. SB951: Higher PFL Payments for Low-Income Workers

In 2002, California enacted the Paid Family Leave ("PFL") program, which is a benefits program funded by employees to provide workers with benefits to care for a seriously ill family member, bond with a new child, or participate in a qualifying event resulting from a family member's military deployment to a foreign country[51]. The PFL program does not grant employees additional leaves of absence; rather, the program provides a percentage of the employee's income while the employee is out of work on a leave of absence. The program is funded by State Disability Insurance withholding from employee paychecks and, until SB951 was passed, paid out 60-70% of an employee's regular income for up to eight weeks in a 12-month period.

Senate Bill 951 proposed to increase the percentage of income paid out to low-income workers and to remove a contribution limit for high-income workers. Under existing law, for 2022, the maximum contribution withheld from any employee, including high-income earners, is around $1,600.[52] SB951 repeals this section of the law that sets the maximum contribution limit beginning January 1, 2024. By removing the contribution limits, SB951 will provide for higher funding to the program such that higher benefits can be paid out. Effective January 1, 2025, low-income workers, those who earn between $722.50 per quarter and 70 percent of the state average quarterly wage, will receive 90 percent of their wages in benefits payments.

The Legislature and a number of organizations supported SB951 in an effort to allow low-income workers the benefit of taking time off to care for family and bond with new children. According to statistics, low-income workers would not take time off because the PFL payments

[49] Cal. Code Civ. Proc. Pt. 2, Title 9, Div. 2, Ch. 5.
[50] Cal. Code Civ. Proc. § 706.050, effective September 1, 2023.
[51] Cal. UI Code § 3300 *et seq.*
[52] Cal. UI Code §984(a).

were too low for them to maintain a standard of living. With the higher benefit payments under SB951, minimum wage earners will be more likely to take time off and collect PFL benefits to support the time off. Employers are advised to anticipate employees taking advantage of longer or more frequent leaves of absence as the higher supplemental pay benefits become available.

18. AB1655, AB2596, AB1801: New Recognition of Holidays

The Governor signed three bills that propose to add state holidays to the calendar. Effective January 1, 2023, the state of California will recognize the following days as a holiday: Juneteenth on June 19; Genocide Remembrance Day on April 24; and Lunar New Year on a date to be determined that typically falls between January and the first month of the lunar calendar. Each of the three bills was drafted to recognize various cultural celebrations of significance and to give employees the option to observe such dates as holidays.

In addition to state employees observing the new holidays, public schools will also close in observance of these holidays. Employers are advised to add these new holidays to their general calendars. There is no law that requires private employers to make these paid holidays; however, employers might consider the impact that school closings will have on its workforce on these additional holidays.

19. AB2431: LLC Statement of Information

By way of background, in 2020, AB3075 was passed in an effort to prevent corporations and limited liability companies ("LLCs") from evading wage order judgments and other penalties for labor law violations.[53] Corporations and LLCs have long been required to submit a statement of information to the Secretary of State with names of officers and the entity's registered agent. Effective January 1, 2022, the statements of information needed to include a statement indicating whether any officer or any director, or, in the case of an LLC, any member or any manager, has an outstanding final judgment for the violation of any wage order or provision of the Labor Code.[54] Further, AB3075 established that a successor to any judgment debtor is liable for any wages, damages, and penalties its predecessor employer owes to any of the predecessor employer's former workforce.[55] A business is determined to be a successor under this section when:

- The successor uses substantially the same facilities or workforce to offer substantially the same services as the judgment debtor;
- The successor has substantially the same owners or managers that control the labor relations as the judgment debtor;
- A managing agent of the successor also directly controlled the wages, hours, or conditions of the employees of the judgment debtor; or

[53] Cal. Labor Code § 200.3; Cal. Corp. Code §§ 1502, 2117, 17702.09.
[54] Cal. Corp. Code §§ 1502(a)(10), 17702.09(a)(8).
[55] Cal. Labor Code § 200.3(a).

- The owner, partner, officer, or director of a business within the same industry as the judgment debtor is an immediate family member of any owner, partner, officer, or director of the judgment debtor.

This year, the state legislature determined that AB3075 did not have the intended impact on certain types of LLCs. Some LLCs are structured in a way where the members hire one or more managers to handle the LLC's business decisions, thereby rendering the members to passive investors much akin to the shareholders of a corporation. Under AB3075, the statement of information would have had to include such passive investor-members of an LLC. Under AB3075, the statement of information, however, would not include shareholders of a corporation. Accordingly, this year's AB2431 was designed to address this inconsistency in the law's application.

AB2431 makes the disclosure requirement for an LLC consistent with that of a corporation by limiting the requirement to managers and only those members who are agents of the business. Effective January 1, 2023, the statement requirements differ depending on the structure of the LLC. For LLCs that are member-managed, the statement of information to the Secretary of State must include whether any member has an outstanding final judgment for the violation of any wage order or provision of the Labor Code, and this requirement is limited to only the members who, as specified in a written operating agreement, are agents of the LLC for the purpose of its business and affairs. Conversely, for LLCs that are manager-managed, the state of information must include whether any manager has an outstanding final judgment.[56] Members (unless the member is also a manager) are now excluded from the statement of information for manager-managed LLCs.

This will impact compliance measures for financial institution subsidiaries which are LLCs registered or formed in California.

### B. Bankruptcy/Collections Updates

California law as to debt collection had important clarifying changes in 2022, as a number of "exemptions," and how they are processed, change as of January 1, 2023. Reworking collections and legal process processing will be important.

#### 1. SB1099: Bankruptcy - Debtors

Among other things, SB1099 provides that the mere act of filing a bankruptcy proceeding, or the status as a debtor of any obligor on a loan does not constitute a default and cannot be used to justify acceleration of the loan. Any provision to the contrary in a loan agreement would be void and unenforceable. Further, the bill provides that both exemptions and the value of property shall be determined as of the date of the filing of the bankruptcy, and to the extent the value of the exemption exceeds the value of the property, any subsequent increases in the value of the property during the pendency of the case belong to the debtor.

[56] Cal. Corp. Code § 17702.09(8)(A) and (B), effective January 1, 2023.

In addition to these two primary provisions, SB1099 has a number of other provisions that make changes to the existing exemptions available to debtors under the two exemption schemes offered under California law. California allows debtors in bankruptcy to elect between two alternative exemption "schemes." The first is known as the "homestead" exemption scheme, and the main exemption under that scheme is geared toward exempting a significant portion of equity in a homestead. The homestead exemption scheme applies to both non-bankruptcy judgment debtors and bankruptcies. In contrast, the alternative exemption scheme, known as the "wildcard" scheme, focuses the "main" exemption under the scheme on allowing the judgment debtor a large chunk of value to apply to any sort of asset. The "wildcard" exemption scheme applies only in bankruptcies.

Existing law requires spouses filing jointly to pick the same set of exemptions (either the homestead exemptions or the "wildcard" exemptions, but not both). Where spouses file individual petitions, they are both assumed to elect the homestead exemption scheme, except where they have agreed in writing to elect the wildcard exemption scheme. However, SB1099 provides that this waiver is not needed where married debtors filing individually are living separate and apart from their spouse as of the date the bankruptcy petition is filed. The exception to this new rule is where, on the petition date, the spouses shared an ownership interest in property that could be exempted as a homestead, in which case they must still both agree to elect the wildcard exemption or will be stuck with the homestead scheme.

In addition to these foundational changes regarding how and when spouses are entitled to elect either of the two schemes, SB1099 makes the following separate changes to each of the schemes:

- <u>The Homestead Exemption Scheme:</u>
  - The motor vehicle/motor vehicle-related exemption is increased to $7,500 from $3,325;
  - Vacation credits are already exempt, under the homestead scheme, from enforcement of a money judgment without making a claim. SB1099 expands the homestead exemption to include accrued or unused vacation pay, sick leave, or family leave, limits the aggregate exemption to $7,500, and requires a claim to be asserted as to the exemption (as opposed to it previously being exempt without making a claim);
  - SB1099 adds an exemption for the debtor's right to receive alimony, support, or separate maintenance, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor. This brings it into conformity with the wildcard scheme, which already offered this exemption.
  - The homestead scheme already provides an exemption for health aids reasonably necessary to enable the judgment debtor or the spouse or a dependent of the judgment debtor to work or sustain health, and prosthetic and orthopedic appliances. SB1099 expands this exemption by including a vehicle converted for use by the debtor, the debtor's spouse, or a dependent of the debtor, who has a disability, under the category of "health aid."

- <u>The Wildcard Exemption Scheme:</u>

- SB1099 adds an exemption covering the debtor's right to receive the aggregate interest, not to exceed $7,500, in vacation credits or accrued, or unused, vacation pay, sick leave, family leave, or wages.
- The motor vehicle/motor vehicle-related exemption is increased to $7,500 from $5,850.
- The wildcard scheme already provides an exemption for professionally prescribed health aids for the debtor or a dependent of the debtor. SB1099 expands this exemption by including a vehicle converted for use by the debtor, the debtor's spouse (previously, it was only for the debtor or dependent of the debtor), or a dependent of the debtor, who has a disability, under the category of "professionally prescribed health aid."
- SB1099 also adds an exemption for a payment under a settlement agreement arising out of or regarding the debtor's employment, to the extent reasonably necessary for the support of the debtor, the debtor's spouse, and a dependent of the debtor. The bill also extends existing exemptions for other types of payments (i.e., (1) payment under a life insurance contract, (2) payment on account of personal bodily injury; and (3) payment in compensation of loss of future earnings to the debtor's spouse, as opposed to just the debtor and debtor's dependent (or person for whom the debtor is a dependent).

In general, the changes to the exemptions provided by SB1099 are intended to expand the scope and amount of exemptions available to debtors, which is consistent with changes made in prior years, including the very significant change made effective January 1, 2021, which increased homesteads from $75,000 (unmarried filers to whom no other exemption was applicable), $100,000 (married fields to whom no other exemption was applicable), or $175,000 (disabled filers or those sixty-five (65) and older to a range from $300,000.00 to $600,000.00. While these more recent changes to the exemptions are not as significant as the 2021 change to the homestead exemption, they should still allow debtors to keep more assets for their "fresh start."

Finally, as mentioned above, SB1099 invalidates any provision that permits defaulting and accelerating a loan on the basis of a bankruptcy filing alone. This appears to be a codification of the invalidation of *ipso facto* clauses (*i.e.*, a provision that declares a default in the event of insolvency or bankruptcy, or would otherwise affect and/or waive the rights of a debtor in bankruptcy) that most bankruptcy courts apply. Thus, while not groundbreaking, it does eliminate any uncertainty over whether such a clause is valid.

2. SB1200: Enforcement of Judgment – Renewal and Interest

Under existing law, judgments may generally be renewed upon application in ten- (10-) year increments. However, SB1200 amends the California Code of Civil Procedure so that a money judgment of under $200,000 that remains unsatisfied for a claim relating to medical expenses and for a money judgment of under $50,000 that remains unsatisfied for a claim related to personal debt can only be renewed once, and only for a period of five (5) years. Further, if an application for extension had already been sought as to these types of judgments prior to December 31, 2022, no application for renewal will be permitted beginning January 1, 2023. In addition, the existing right of a judgment debtor to make a motion to vacate or modify the

renewal within thirty (30) days of service of a notice of renewal of the judgment has now been extended to sixty (60) days.

Also, as to money judgments of under $200,000 that remain unsatisfied for a claim related to medical expenses and money judgments of under $50,000 that remain unsatisfied for a claim related to personal debt, the usual rule the interest accrues at the rate of 10% per annum on the principal amount will not be applicable, and interest will instead be limited to 5% per annum.

While the changes relating to medical debt are unlikely to impact financial institutions, the provisions relating to personal debt under $50,000.00 will constrict the ability to recover on such debt by limiting renewal of the judgments on such debt, and reducing the interest that can be accrued on the judgments for such debt.

## C. Automobile Lending Updates

Significant shakeups in the automobile lending world extend beyond the protections for servicemembers. Both consumer protections and the overall changes coming to the car market have made the legislative priority list. "Add-on" products, sometimes a significant source of revenue in conjunction with car loans, have long been subject to criticism and class action litigation, but now have significant updates to the legislative scheme. Separately, we see changes coming to the car market in the form of electric vehicles.

### 1. AB2311: GAP Waivers and Insurance

AB2311 amends California's Automobile Sales Finance Act.[57] This chapter of the Civil Code is also known as the Rees-Levering Motor Vehicle Sales Finance Act (the "RLA") and is a consumer protection law that governs the sale of motor vehicles using conditional sale contracts. AB2311 is California's response to the growing nationwide public focus on the lack of protections available for purchasers of Guaranteed Asset Protection ("GAP") products. Among other things, it includes new disclosure requirements, caps on the amount of GAP waiver premiums that may be charged, prohibits penalty, cancellation/termination, and similar fees, and provides a new penalty specific to the failure to refund unearned premiums. However, financial institutions will find the new duties with respect to the refund of unearned premiums that are imposed upon "holders" of the conditional sales contracts to have the most significant impact upon their indirect lending operations.

The effective date of AB2311 is January 1, 2023. However, although the notice/disclosure and other contractual requirements will only impact conditional sale contracts accompanied by the purchase of GAP waivers that were entered into January 1, 2023 and after, the refund obligations with respect to unearned premiums are not expressly limited to contacts entered into after that date. Thus, in the absence of express contrary authority, AB2311's refund provisions should be interpreted as applying to conditional sale contracts accompanied by GAP waivers, no matter when the contract was entered into or the loan was funded.

[57] Cal. Civ. Code § 2981, *et seq.*

The new obligations under AB2311 can be broken down into two categories: (1) those imposed at and in relation to origination, and (2) those relating to post-origination servicing and termination of the GAP waivers.

**<u>Origination Obligations</u>**: While the origination obligations are obligations of the Seller simply due to the timing related to the obligation (*i.e.*, at the outset of the transaction and therefore in the Conditional Sale Contract and/or GAP Document (as defined below)), it's still important for financial institutions to be familiar with these obligations in conducting their due diligence process to mitigate the risk of selecting contracts for purchase that have disclosure or other issues and, thus, present a higher potential for claims against the financial institution as the Holder.

*Conditional Sale Contracts*

Conditional Sale Contracts must contain the disclosures required by Regulation Z,[58] whether or not Regulation Z applies to the transaction, as well as the disclosures required under the RLA, to the extent applicable. In addition, AB 2311 has added the following disclosures, to be provided in any Conditional Sale Contract which is new as of January 1, 2023:

i. <u>Itemization:</u> Itemization of the amount financed for the amount charged for any GAP waiver;[59] and
ii. <u>Pre-execution Ancillary Product List</u>: If the Conditional Sale Contract includes a charge for a GAP waiver, then prior to the execution of the Conditional Sale Contract, the Seller has to provide the Buyer with a written disclosure that sets forth the description and price of, among other items, any GAP waiver, and obtain the Buyer's signature on the disclosure.[60]

*GAP Waiver Documents*

The terms and conditions of any GAP waiver must appear on a document separate from the Conditional Sale Contract and a Buyer/potential Buyer is required to separately sign the separate GAP waiver document (the "GAP Document").[61] The GAP Document can be titled as an addendum, and forms a part of, and must remain a part of, the Conditional Sale Contract, even upon the sale, transfer, or assignment of the Conditional Sale Contract.[62]

The GAP Document must do the following:

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[58] 12 C.F.R. Part 1026.
[59] Cal. Civ. Code § 2982(a)(1)(A), (K).
[60] The current version of the RLA already requires this disclosure for other ancillary products, but prior to AB 2311, California Civil Code Section 2982.2(a)(1)(B)(iii) only listed a "debt cancellation agreement" among the other items (California Civil Code Section 2982.2(a)(1)(B)(i)-(ii) & (iv)-(vi)) that had to be described and priced on this disclosure (these include other ancillary products such as service contracts and theft deterrent devices). AB 2311 has amended California Civil Code Section 2982.2(a)(1)(B)(iii) so that it now reads: "debt cancellation agreement or guaranteed asset protection waiver agreement."
[61] Cal. Civ. Code § 2982.12(a)(4)(A).
[62] Cal. Civ. Code § 2982.12(a)(2).

i. State that the GAP Waiver is optional and provide the contact information of the Seller or Holder:[63] Conspicuously state that the GAP waiver is an optional addition to the Conditional Sale Contract, and that the Holder of the Conditional Sale Contract is the contracting party to the GAP waiver, and state the name and mailing address of the seller.

If the Conditional Sale Contract is assigned, within thirty (30) days of the assignment, written notice of the assignment of both the Conditional Sale Contract and GAP Document, as well as the assignee's name and mailing address, shall be provided to the Buyer in person or by mail, or by a means of notice that the Buyer previously agreed to with the Seller or Holder in connection with the Conditional Sale Contract.

ii. Provide the administrator's contact information:[64] Conspicuously disclose the name and mailing address of any administrator known as of the date of the sale. For the purposes of Civil Code § 2982.12, the term "administrator" means any person, other than an insurer, that performs administrative or operational functions in connection with the GAP waiver. An administrator is deemed to be an agent of the Holder under the GAP waiver and Civil Code § 2982.12.

iii. Bolded language above the signature line of the GAP Document:[65] Contain a notice with a heading in at least 12-point bold type and the text in at least 10-point bold type, circumscribed by a line, immediately above the contract signature line, that reads as follows:

**STOP AND READ:**

**YOU CANNOT BE REQUIRED TO BUY A GAP WAIVER OR ANY OTHER OPTIONAL ADD-ON PRODUCTS OR SERVICES. IT IS OPTIONAL.**
**NO ONE CAN MAKE YOU BUY A GAP WAIVER OR ANY OTHER OPTIONAL ADD-ON PRODUCTS OR SERVICES TO GET FINANCING, TO GET CERTAIN FINANCING TERMS, OR TO GET CERTAIN TERMS FOR THE SALE OF A VEHICLE.**

**IT IS UNLAWFUL TO REQUIRE OR ATTEMPT TO REQUIRE THE PURCHASE OF THIS GAP WAIVER OR ANY OTHER OPTIONAL ADD-ON PRODUCTS OR SERVICES.**

*Limitations*

In addition to the specific disclosure requirements imposed as to the Conditional Sale Contract and GAP Document, AB2311 imposes the following limitations with respect to the origination of GAP waivers:

[63] Cal. Civ. Code § 2982.12(a)(4)(B)(i).
[64] Cal. Civ. Code § 2982.12(a)(4)(B)(ii).
[65] Cal. Civ. Code § 2982.12(a)(4)(B)(iii).

i. No Conditioning Terms on Purchase of GAP Waiver: Neither the extension of credit, the term of credit, nor the terms of a Conditional Sale Contract can be conditioned upon the purchase of a GAP waiver.[66]

ii. Amount Charged Cannot Exceed Four Percent (4%): The amount charged for a GAP waiver cannot exceed four percent (4%) of the amount the Buyer finances under a Conditional Sale Contract;[67]

iii. Amount Financed Cannot Exceed Amount Covered by GAP Waiver: It is prohibited to sell a GAP waiver in which the maximum dollar amount covered by the GAP waiver is exceeded by the amount financed through the Conditional Sale Contract;[68]

iv. The Conditional Sale Contract Loan-to-Value Ratio Cannot Exceed the Loan-to-Value Ratio Covered by the GAP Waiver:[69] The Conditional Sale Contract's loan-to-value ratio[70] at the contracting date cannot exceed the maximum loan-to-value ratio covered by the GAP waiver. In order to be exempted from this prohibition:
   a. the terms of the GAP waiver must conspicuously disclose the maximum loan-to-value ratio limitation, including the method by which the limitation is applied; and
   b. the Buyer must be informed in a writing, acknowledged by the Buyer, that the amount financed in the Buyer's Conditional Sale Contract exceeds the GAP waiver's maximum loan-to-value limitation, such that the waiver will not cover the total amount owed on the Conditional Sale Contract.

v. A GAP Waiver Cannot Be Sold Where the Amount Financed is Less Than Seventy Percent (70%) of the MSRP: It is prohibited to sell a GAP waiver where the amount financed through a Conditional Sale Contract is less than seventy percent (70%) of the manufacturer-suggested retail price (MSRP) for a new motor vehicle or the average retail value for a used motor vehicle, as determined by a nationally recognized pricing guide, as defined in paragraph (2) of subdivision (c) of § 11950 of the Vehicle Code.[71]

**Servicing and Termination Obligations:** From a financial institution's perspective, these obligations will be the most significant, because they are imposed on the Holder (which is typically the position that financial institutions hold when they become involved in Conditional Sale Contract transactions). The majority of these obligations and rights revolve around the Buyer's right to a refund of unearned premiums.

*Notice To Buyer*

[66] Cal. Civ. Code § 2982.12(a)(3).
[67] Cal. Civ. Code § 2982.12(a)(5)(A).
[68] Cal. Civ. Code § 2982.12(a)(5)(B)(i).
[69] Cal. Civ. Code § 2982.12(a)(5)(B(ii).
[70] As used in California Civil Code § 2982.12(a)(5)(B)(ii), the term "loan-to-value ratio" means the total amount financed through a Conditional Sale Contract as a percentage of the manufacturer suggested retail price for a new motor vehicle or the average retail value for a used motor vehicle, as determined by a nationally recognized pricing guide, as defined in paragraph (2) of subdivision (c) of § 11950 of the Vehicle Code.
[71] Cal. Civ. Code § 2982.12(a)(5)(B)(iii).

When communicating in writing an itemized contract balance to the Buyer, including a payoff letter, payoff quote, or any written notice required under Civil Code § 2983.2(a) (dealing with notice of the intent to dispose of a surrendered or repossessed motor vehicle) or Financial Code § 22328(b) (also dealing with the notice of intent to dispose of a repossessed or surrendered motor vehicle), the Holder of a Conditional Sale Contract that includes a GAP waiver must do either of the following:[72]

i. Individually identify as a credit or refund available to the Buyer the unearned portion of all GAP waiver charges paid by the Buyer as of the date of the communication on a pro rata basis; or
ii. Conspicuously state that a Buyer who purchased a GAP waiver is generally entitled to a refund of the unearned portion of the GAP waiver charges on a pro rata basis upon early termination of their Conditional Sale Contract or cancellation of the GAP waiver, and that the Buyer should contact the administrator identified in the Buyer's GAP Document, or any other appropriate person designated by the Holder, for identification of the amount of such a refund available to the Buyer at that time.[73]

The Conditional Sale Contract cannot "contract around" or waive this right.

*Right to Refund Upon Termination*

The bill also provides that a GAP waiver terminates upon the earliest of the following events:[74]

i. Cancellation of the GAP waiver by the Buyer;
ii. Payment in full by the Buyer of the Conditional Sale Contract;
iii. Expiration of any redemption and reinstatement periods after a repossession or surrender of the motor vehicle specified in the Conditional Sale Contract;[75]
iv. Upon total loss or unrecovered theft of the motor vehicle specified in the Conditional Sale Contract, after the Holder has applied all applicable benefits required under the GAP waiver; and
v. Upon any other event that occurs earlier than the four (4) events listed above, as specified in the GAP waiver.

Upon termination of the GAP waiver, a Buyer is entitled to a refund as follows (this is often referred to as a refund of "unearned premiums"):[76]

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[72] Cal. Civ. Code § 2982.12(a)(6).
[73] This alternative is provided due to the recognition that the Holder may not always have the information needed to calculate the unearned premium amount, particularly where the GAP waiver was purchased prior to January 1, 2023 (and therefore before the relevant disclosure requirements were imposed).
[74] Cal. Civ. Code § 2982.12(b)(1).
[75] Cal. Civ. Code § 2983.2(a).
[76] Cal. Civ. Code § 2982.12(b)(2). However, no refund is required upon termination if there has been a total loss or unrecovered theft of the motor vehicle specified in the Conditional Sale Contract and the Buyer has or will receive the benefit of the GAP waiver. Cal. Civ. Code § 2982.12(b)(2)(C).

i. Within Thirty (30) Days of Purchase: If the termination occurs within thirty (30) days after the date the Buyer purchased the GAP waiver, the Buyer is entitled to a full refund of the GAP waiver charges plus all finance charges attributable to the GAP waiver.

ii. Later Than Thirty (30) Days After Purchase: If the termination occurs later than thirty (30) days after the date the Buyer purchased the GAP waiver, the Buyer is entitled to a refund of the unearned GAP waiver charges, which shall be calculated on a pro rata basis.

The timing of the refund is also dictated under the bill. [77] Within sixty (60) business days from the termination of a GAP waiver, the Holder must tender the unearned premium or cause the refund to be made by instructing in writing the administrator or any other appropriate party to make the refund.

*No Penalties or Cancellation Fees*

A GAP waiver may be canceled by the Buyer at any time without penalty[78] and no cancellation fee, termination fee, or similar fee shall may be assessed in connection with the termination of a GAP waiver.[79]

While these provisions have been included in the servicing/termination section, they are also an origination obligation that financial institutions will need to review for in doing their due diligence on purchases of Conditional Sale Contracts.

*Records Retention*

In addition to the requirements of Civil Code § 2984.5 (relating to documents to be maintained by the Seller for a period of seven (7) years), the Holder is required to maintain records identifying any refund of unearned premiums, including those refunds the Holder instructed the administrator or other appropriate party to make, and provide electronic access to those records, in response to any subpoena or other administratively or judicially enforceable request, until four (4) years after the date the refund was tendered.[80]

*New Penalty/Remedy Provision*[81]

AB2311 adds a new remedy/penalty at Civil Code § 2983.1(b). Under that section, if Holder of a Conditional Sale Contract that includes a GAP waiver, except as the result of an accidental or bona fide error of computation, violates any provision of Civil Code § 2982.12(b) (relating to termination or cancellation of the GAP waiver and the related refund of any unearned premiums, as well as records retention requirements), the Buyer may recover from the Holder three (3) times the amount of any GAP waiver charges paid.

[77] Cal. Civ. Code § 2982.12(b)(3).
[78] Cal. Civ. Code § 2982.12(b)(4).
[79] Cal. Civ. Code § 2982.12(b)(5).
[80] Cal. Civ. Code § 2982.12(b)(6).
[81] Cal. Civ. Code § 2983.1(b).

2. SB2330: Total Loss Salvage and Nonrepairable Vehicles

SB2330 streamlines the existing requirements for an insurance company or a salvage pool authorized by an insurance company to receive a salvage certificate or nonrepairable vehicle certificate from the DMV. Specifically, where an insurance company or a salvage pool authorized by an insurance company takes possession of a salvage vehicle or a nonrepairable vehicle in a total loss settlement, they are required to transmit the information over to DMV along with a certificate of ownership in order to receive a salvage certificate or nonrepairable vehicle certificate. Without the salvage certificate or nonrepairable vehicle certificate, insurance companies are forced to store these inoperable vehicles in the lot waiting for the replacement title.

Existing law requires the owner, within ten (10) days from the settlement of loss, to forward to the department the properly endorsed certificate of ownership or other evidence of ownership acceptable to the department, the license plates, and a specified fee. However, the previous owner of the vehicle has no incentive to provide the certificate of ownership to the insurance company, as the settlement on the loss of the vehicle has already occurred, the previous owner no longer possesses the vehicle, and the previous owner would be required to spend their own money and time to get the title transfer.

Prior to 2006, California lacked a process to obtain a vehicle title if that vehicle was involved in an accident and the prior vehicle owner did not submit title/ownership information to their insurance company. A 2006 law, AB1122, created a process where if the insurance company had already settled the insurance claim with the policyholder, had waited 30 days, and made two additional written attempts to try to obtain the title/ownership information from the policyholder, the DMV could issue a salvage certificate or nonrepairable vehicle certificate to the insurance company without proof of certificate of ownership so long as the insurance company attested to the DMV under penalty of perjury that it had made at least two written attempts to the original owner for the certificate of ownership.

SB2330 authorizes an insurance company or a salvage pool authorized by an insurance company to request a salvage certificate or nonrepairable vehicle certificate from the DMV without a properly endorsed certificate of ownership within fifteen (15) days after the insurance company makes a total loss settlement on a total loss salvage vehicle, so long as they attest to DMV that they made a single attempt to receive a certificate of ownership from the previous owner of the vehicle. The attempt can be made by first-class mail, certificate of mailing, certified mail, other commercially available delivery service showing proof of delivery, or email.

3. AB2061: Electric Vehicle Charging Infrastructure

The Clean Transportation Program, administered by the State Energy Resources Conservation and Development Commission (the "Energy Commission"), provides grants and revolving loans to further the state's climate change policies, including migrating away from California's reliance on fossil fuels (including petroleum) and internal combustion powered vehicles. The Public Utilities Commission (the "PUC"), the Energy Commission, and the State Air Resources Board (the "State Board") are focused on programs to induce transportation electrification in an

effort to reduce dependence on petroleum fuel and cut emissions of greenhouse gases to 40% below 1990 levels by 2030 and to 80% below 1990 levels by 2050. Part of the investment plan requires the Energy Commission and the State Board to assess whether charging station infrastructure is disproportionately deployed in high-income communities. If the Energy Commission and State Board determine there is disproportionate deployment, the Energy Commission and State Board are authorized to use money from the Alternative and Renewable Fuel and Vehicle Technology Fund, as well as incentives, to more proportionately deploy new charging station infrastructure.

Starting January 1, 2024, the Energy Commission and the PUC are required to develop recordkeeping and reporting, for a minimum period of 6 years, on electric vehicle chargers and charging stations that received an incentive from a state agency or through a charge on ratepayers and were installed after that date. Starting on January 1, 2025, the bill requires the Energy Commission to assess the uptime of charging station infrastructure, including an assessment of equitable access to reliable charging stations in low-, moderate-, and high-income communities. The bill requires the Energy Commission to update the assessment every 2 years. Based upon the results of the assessment, the Energy Commission can adopt policies including uptime requirements, operation and maintenance requirements, and potential operational and maintenance incentives to increase charging station uptime and deploy new charging station infrastructure.

Financial institutions should consider developing complimentary commercial lending programs to facilitate the development and deployment of charging station infrastructure in low-and moderate-income communities. Facilities receiving government incentives, grants, and revolving loans may be at financial competitive advantage in terms of costs when compared to other charging stations and may present a low-risk, high visibility opportunity to finance ESG businesses and promote the financial institution’s commitment to ESG initiatives.

### D. Additional Laws Impacting California Lending & Real Estate

Lending departments will need to review laws both for new challenges and new opportunities for the coming years. While legal updates in 2022 will require certain form changes, trend lines in California also present new opportunities for lending niches.

#### 1. Lender’s Right to Default Interest Invalidated by Court of Appeals

In *Honchariw v. FJM Private Mortgage Fund, LLC*,[82] the California Court of Appeal held that default interest and late fee charges are unlawful when they are assessed against the full outstanding principal balance on a partially matured note, regardless of whether the loan is a consumer or nonconsumer loan. This means the lender is only able to charge an installment late charge and default interest against amounts presently in default (i.e. unpaid installments) and not against the entire principal balance. The prohibition applies regardless of loan purpose (i.e. business and consumer purpose loans) and collateral type (i.e. commercial, residential, and vacant land).

[82] 83 Cal.App.5th 893 (Cal. Ct. App. 2022).

Background

In 2018, Nicolas and Sharon Honchariw obtained a $5.6 million business purpose loan from FJM Private Mortgage Fund ("FJM"). The loan agreement provided in relevant part that, in the event of a default, the plaintiffs would owe a one-time 10 percent fee assessed against the overdue payment and a default interest charge of 9.99 percent assessed annually against the total unpaid principal balance.

In 2019, the plaintiffs missed a monthly payment, which triggered the late payment provisions. The plaintiffs commenced arbitration and argued, among other things, that the "Late Fee" provisions in the loan agreement (*i.e.*, the 10 percent fee and the default interest of 9.99 percent) were unlawful under Section 1671 of the California Civil Code, which requires liquidated damages provisions to bear a "reasonable relationship" to the actual damages that would flow from a breach. The arbitrator rejected the plaintiffs' arguments and ruled in favor of the lender. On appeal, the Superior Court of Sonoma County affirmed the arbitrator's award. The plaintiffs appealed to the Court of Appeal, which reversed the lower court's ruling and vacated the arbitration award.[83]

The Court of Appeal held that the late fee and default interest provisions in the loan agreement, which the court addressed jointly as a "Late Fee," were unlawful under § 1671. Specifically, the court ruled that "a charge for the late payment of a loan installment which is measured against the unpaid balance of the loan must be deemed to be punitive in character," and therefore unenforceable. The court acknowledged that, in the nonconsumer loan context, liquidated damages provisions are presumed to be valid under § 1671. However, the court nonetheless found that default interest assessed against the entire unpaid balance of a loan, in the absence of a maturity default, necessarily does not bear the requisite "reasonable relationship" to actual damages and therefore must be invalidated.

The Court of Appeal principally relied on *Garrett v. Coast & State Federal Savings & Loan Association*,[84] in which the California Supreme Court held that a default interest provision assessed against the entire unpaid principal balance of a partially matured consumer loan was "punitive in character." The *Honchariw* lender argued that *Garrett* interpreted an outdated version of Section 1671 and was therefore no longer good law. The court rejected this argument, however, and held that *Garrett* controlled and required the court to invalidate the default interest provision at hand.

The Court of Appeal also distinguished more recent cases enforcing default interest imposed against the full principal balance upon a borrower's default on *fully matured* obligations, finding that in the case at hand, the fact that the loan was only *partially matured* was dispositive.

The lender sought rehearing of the Court of Appeal's ruling, but that request was denied on October 26, 2022.

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[83] We note with interest that normally arbitration awards cannot be so overruled, but in this instance the Court of Appeals took "interesting" routes to get to its result.
[84] 511 P.2d 1197 (Cal. 1973).

How This Decision Impacts Federal Credit Unions and Other Federal Charters

One of the benefits of a federal charter is the federal preemption that is afforded to federal credit unions under 12 C.F.R. § 701.21(b), which preempts any state law purporting to limit or affect, among other things, rates of interest and amounts of finance charges, including, the authority to increase the interest rate on an existing balance. As the *Honchariw* case is premised on § 1671 of the California Civil Code, which is applied to limit late charges and rates of interest, it may be preempted under 12 C.F.R. § 701.21(b).

However, federal credit unions are not completely out of the woods. If the loan agreements of federal credit unions do not preserve their federal preemption rights, they may be waived. Based on our experience, we have seen many examples of commercial loan documents which have choice of law provisions that are either based on the state in which the lenders operate or the property jurisdiction (i.e., where the collateral is located) without any mention or regard to federal law. SW&M's commercial loan documents already include choice of law provisions that factor in federal law and preemption.

Federal credit unions are advised to review their loan documentations with competent counsel, particularly choice of law provisions, to ensure that they have preserved their federal preemption.

At the same time, it is also possible that a court could take the *Honchariw* decision to another extreme, and say that federal preemption does not extend to liquidated damages, and that the Civil Code is not regulating interest, but rather damages calculations. If lenders are charging default interest in California, even if federally chartered, there is a degree of risk for which mitigating factors should be considered as if lending under a state charter.

How This Decision Impacts State-Chartered Credit Unions

If your credit union is a California state-chartered credit union or an out-of-state credit union that has made loans against collateral located in California where the loan documents recite the property jurisdiction as the governing law, your credit union does not have the benefit of federal preemption in the same way. Thus, the *Honchariw* decision will have more of an impact to your ability to assess default interest.

California state chartered credit unions are advised to seek advice and counsel regarding the impact *Honchariw* has on their current default enforcement practices and ways in which to enforce loan defaults and apply the default rate which mitigates against the risk of the default rate being challenged as an unenforceable penalty under § 1671.

State chartered credit unions from other states lending in California may have benefits from 12 U.S.C. § 1785(g). But as above, tailoring both rate calculation an enforcement practices, as well as choice of law provisions, will be important to defense of default interest collection under this new decision, and so should also consult with counsel.

2. AB2170: First Look Program

AB2170 establishes a state-level “First Look” program, in which individuals, nonprofits, and public entities will have a 30-day window to make offers on post-foreclosure properties that are put up for sale by large lending institutions. This bill is modeled on an existing federal initiative known as the “First Look” program. The “First Look” program creates a 30-day window after a real estate owned property first comes on the market during which only prospective owner occupants may make offers. Investors therefore must wait until after owner occupants have had the first opportunity at securing the property before they can try to acquire it for themselves.

AB2170 creates an exclusive, 30-day window of opportunity immediately after a foreclosed upon property goes on the market. During that window of opportunity, only prospective owner-occupants, certain affordable housing providers, community land trusts, and public entities can make offers. All other interested investors would have to wait.

While the federal “First Look” program applies to properties that were foreclosed upon and wound up in the hands of Freddie Mac or Fannie Mae. AB2170 applies to properties that were foreclosed upon by any institutional lender that acquired at least 175 properties through foreclosure in the preceding year. The 175 property threshold derives from the Homeowners Bill of Rights (HBOR), the laws governing how lenders must interact with homeowners during the foreclosure process. The purpose behind the 175 property threshold is to apply the program to larger, more sophisticated lenders without impacting smaller operators.

AB2170 also restricts the use of “bundled sales” to dispose of multiple foreclosed upon properties. AB2170 clarifies that a “bundled sale” mean the sale of two (2) or more real estate parcels containing one-to-four residential units, of which at least two (2) have been acquired through foreclosure. In a bundled sale, a lending institution sells off a series of properties that it has foreclosed upon all at once. This method of sale is efficient for the lender and helps them to sell off less-desirable properties by grouping them with more-desirable properties. However, bundled sales effectively exclude everyone apart from institutional investors because to buy a bundle of properties, the purchaser must have substantial funds to invest and must be prepared to manage multiple properties. By requiring individual sales of all properties being offered in the wake of foreclosure, the bill ensures that prospective owner-occupants, certain affordable housing providers, community land trusts, and public entities a better chance of acquiring the property.

Along with the offer to the trustee, foreclosure bidders are required to submit a declaration stating they are an eligible bidder. To reduce incidents of fraud, eligible tenant buyers are required to attach evidence of their tenancy with their declaration. Bids are limited to a single amount and may not include escalation clauses, or instructions for successively higher bids. Further, before considering any other offer, the trustee needs to respond in writing to all offers from eligible bidders during the first thirty (30) days of the property being listed for sale.

Financial institutions should review their existing default servicing guidelines to ensure they are compliant with AB2170.

3. AB2245: Partition of Real Property Act

AB2245 is also known as the Partition of Real Property Act. Existing law authorizes an owner of an estate in real property to commence and maintain an action for partition of the property against all persons having or claiming interests in the estate as to which partition is sought. If the court finds that the plaintiff is entitled to partition, it is required to make an interlocutory judgment that determines the interests of all owners of the property and orders that the property be divided among those parties in accordance with their interests or sold with the proceeds divided among them. The predecessor of this Act, the Uniform Partition Heirs Property Act ("UPHPA"), "preserves the right of a co-tenant to sell his or her interest in inherited real estate, while ensuring that the other co-tenants will have the necessary due process to prevent a forced sale: notice, appraisal, and right of first refusal." The Act aims to prevent dispossession of property by way of a forced sale. For many, property is their most valuable asset. Being forced to sell this asset can potentially negatively impact those who co-own the property.

The Act removes references to "heirs property" and related terminology in UPHPA so that the procedures for partition under UPHPA becomes applicable to partition of any real property owned by tenants in common. State intestacy laws and less sophisticated estate planning documents will name heirs as tenants in common. Any tenant in common who has no need or desire to maintain ownership in the property may file for a partition action. However, under the UPHPA in California, co-owners who wish to retain their ownership in the inherited property have more opportunity to do so, thus preserving generational property wealth that may be otherwise lost in a partition by sale. Notably, by removing the condition under the UPHPA requiring the property to be "heirs property", the Act expands the scope of partition actions far beyond those included in the UPHPA. The new law also specifies that the UPHPA partition procedures should be followed in situations where there is no other agreed upon and recorded procedure for partition that binds all the cotenants.

Thus, the Act allows co-owners of property a much easier way to buy out their co-owners, expanding even further upon the UPHPA. Owners of property that is resided in by their co-owner now have a simpler way to request their co-owners to buy them out or move on so that everyone can obtain their equity. The Act in California accomplishes these goals by forcing a partition by appraisal where it would otherwise not be allowed.

The new law will apply to actions for partition of real property filed on or after January 1, 2023, and supersedes any conflicting provisions of the title of the Code of Civil Procedure governing partition of property.

4. AB 1837: Homes for Homeowners

AB1837 serves to reform 2020's SB1079. AB1837 is designed to close certain loopholes in SB1079 and give priority to tenants, homeowners struggling to pay a mortgage and stay in their homes and affordable housing organizations seeking to provide affordable housing in foreclosure sales.

SB1079 is known as the "Homes for Homeowners, Not for Corporations" bill. It changed existing law related to the foreclosures of homes to prohibit the bundling 1-to-4-unit residential properties during foreclosure. It also gives tenants, nonprofits, and government entities an extra window of time to place a bid on a property in a foreclosure auction, and to only meet the last, highest bid in the regular foreclosure auction to be the prevailing bidder. The goal was to make it easier for ordinary individuals, tenants, and nonprofits to access properties in foreclosure auctions, which are generally fast-paced and dominated by real estate speculator-investors. While there have been individuals who have successfully used SB1079 to purchase and remain in the houses they live in, many others have lost their homes to profit-minded organizations misusing SB1079. These organizations, many under the guise of charitable causes, have used the law to flip houses for profit violating the intent of SB1079.

AB1837 extends the priority process for bidding by a prospective owner-occupant until January 1, 2031. The definition of an eligible tenant buyer is redefined to also describe natural people who are occupying property under a rental or lease agreement with a mortgagor's or trustor's predecessor in interest. The bill also revises the definitions of an eligible nonprofit corporation and limited liability company for purposes of making them eligible bidders. Specifically, to be an eligible bidder, the organization must be a/an nonprofit whose main activities must include development and preservation of affordable rental or homeownership housing in California, an LLC wholly owned by a nonprofit that meets the above requirement, a Community land trust, or a limited equity housing cooperative.

The affidavit and declaration requirements for eligible bidders have been expanded to deter fraud as well as to address the new requirements the bill has imposed regarding the use of properties as affordable housing and the treatment of tenants following purchase. AB1837 requires specified successful eligible bidders at foreclosure sales to maintain properties as affordable housing for lower income households for a minimum of thirty (30) years and prescribes requirements for eviction of certain tenants in the case of multi-unit property purchased by a prospective owner-occupant.

A trustee or its authorized agent would be required to send specified information to the Attorney General where the winning bidder at a trustee sale to which this process applies is an eligible bidder within fifteen (15) days after a foreclosure sale is deemed final. The Attorney General, a county counsel, a city attorney, or a district attorney could bring an action to enforce these provisions.

Financial institutions should carefully review their lending and servicing guidelines to ensure compliance with both SB1079 and AB1837.

5. AB221 & SB897: Accessory Dwelling Units

AB2221 and SB897 are intended to further streamline the permitting process and modifies construction regulations for Accessory Dwelling Units ("ADU"). These two bills make substantial revisions to state law and will likely require local jurisdictions to review and readopt any local ordinances related to ADUs. The implementation of these bills continues the current legislative trend aimed at increasing construction to address the need for additional residential

housing stock in California. As is the norm, the bills go into effect January 1, 2023; when they do, any local ordinance that does not conform to AB2221's and SB897's changes to state's ADU laws will be null and void.

AB2221 makes it easier to build ADUs. Housing advocates contend as infill development, ADUs make efficient and "green" use of existing infrastructure and help increase densities to levels at which transit becomes viable—with lower costs and quicker permitting processes than for larger, multi-family building types. Because ADUs tend to be relatively small and their amenities modest, they provide more affordable housing options. Housing advocates have long argued that local governments misuse loopholes to block ADU projects. AB2221, among other things, provides for the creation of accessory dwelling units by local ordinance, or, if a local agency has not adopted an ordinance, by ministerial approval, in accordance with specified standards and conditions. AB2221 limits the ability of local jurisdictions to impose restrictions on ADUs by clarifying many of the existing rules and technical definitions.

AB2221 prohibits local governments from requiring a zoning clearance or separate zoning review, prevents local governments from imposing front setbacks if they would prevent an ADU that is at least 800 square feet, restricts the ability of local governments to impose height limits, clarifies that a detached ADU can include a detached garage, allows developers to add ADUs to properties with proposed multifamily buildings, and confirms that only objective standards may be used for review.

AB2221 also clarifies that permitting agencies must "approve or deny" a proposed ADU within 60 days of receiving a complete application, whereas current law uses the more ambiguous term "act on." Further, if the permitting agency denies the application, it must return in writing a full set of comments to the applicant with a list of items that are defective or deficient and a description of how the application can be remedied by the applicant, and may not add new items on re-application. The definition of "permit agency" bound by the 60-day deadline has been clarified to apply to all permitting authorities, such as public utilities and special districts, not just the planning counter.

In conclusion, AB2221 effectively makes it easier for property owners to get their ADUs approved and further restricts the ability of local governments to impose development standards on these units. Accordingly, financial institutions should implement lending policies and programs to take advantage of the continued construction of ADUs in California.

6. <u>SB1495: Department of Real Estate and Licensing Requirements</u>

SB1495, in pertinent part and as relevant to financial institutions, revises the coursework currently required under existing law for a real estate broker license and real estate salesperson license and delays implementation of those revisions until January 1, 2024. SB1495 also updates the reference to "Nationwide Mortgage Licensing System and Registry" in the California Real Estate Law with its revised name "Nationwide Multistate Licensing System and Registry".

As related to the revised coursework requirement, existing law provides that real estate brokers and salespersons must complete 45 hours of continuing education within a four-year period

preceding a license renewal application. SB263, a prior bill that was set to take effect on January 1, 2023, provided updated training requirements for California Department of Real Estate ("DRE") licensees, including real estate brokers and salespersons. In this regard, SB263 revised the legal aspects of the real estate course to include a component on state and federal fair housing laws, and also required a two-hour implicit bias course within the 45 hours of continuing education requirement.

Having said that, the DRE noted some implementation issues with the provisions of SB263. As such, SB1495 makes a number of technical amendments to ensure SB263 is implementable and further delays the operative provisions of SB263 until January 1, 2024, so courses can be updated to allow both brokers and salespersons to comply with the updated required coursework.

SB1495 is a good reminder for financial institutions to ensure that their respective employees who are DRE licensees are fulfilling their educational requirements and keeping up with the required courses, which are set to change per SB1495 on January 1, 2024.

### E. Miscellaneous

Additional bills enacted in 2022 will have important impacts on operations.

#### 1. AB2280: Unclaimed Property: Interest Assessments and Disclosure of Records

Under existing law, unclaimed property escheats to the state after the periods specified in California's Unclaimed Property Law ("UPL"). Under the UPL there are various penalties that can be assessed to holders of property that fail to delivery unclaimed property in a timely manner or that fail to report in substantial compliance with statutory requirements. In addition to damages, penalties and fines, the holder of property is required to pay interest to the State Controller's Office ("SCO") at a rate of twelve percent (12%) per annum on the value of the property from the date the property should have been reported, paid or delivered. The interest is capped at $10,000 if property is delivered timely, but the report is not in substantial compliance with the law. Interest can be waived by the SCO if the failure to report in compliance with legal requirements is due to reasonable cause.

In recognizing that many holders of unclaimed property are not complying with the UPL, particularly with respect to past due unclaimed property, due, at least in part, to the substantial interest penalties associated with late delivery of such property to the SCO, the California Legislature passed AB2280, which, among other things, establishes the statutory framework for the California Voluntary Compliance Program ("VCP"). AB2280 authorizes the SCO to establish the VCP which will grant leniency to participants that find, report, and deliver overdue unclaimed property.

Generally, participants will need to seek approval from the SCO to enroll in the VCP. Once approved, participants will be required to:

- Enroll in an unclaimed property educational training program provided by the SCO;

- Review their books and records for unclaimed property for at least the previous ten (10) years;
- Report unclaimed property to the SCO within six months of being notified of their enrollment in the VCP;
- Notify property owners of reportable property by mail no less than 30 days before submitting the report to the SCO; and
- Submit an updated report and deliver still unclaimed property to the SCO seven months after the SCO received the original report.

If participants satisfy the requirements of the VCP, the SCO is required to waive the statutory interest penalties with respect to the unclaimed property that is delivered.

It is important to note that not everyone will be eligible for the VCP at all times. Holders of property are ineligible if:

- The holder is subject to, or has received notice of a pending SCO examination;
- The holder is the current subject of a civil or criminal prosecution involving compliance with the UPL;
- The SCO has assessed interest on property with respect to the holder within the last five years and the interest remains unpaid; or
- The SCO has waived interest assessed against the holder within the previous five years (though holders that have acquired unclaimed property as a result of a merger or acquisition during the five-year period may enroll in the VCP with respect to resolving that unclaimed property).

Once implemented, California will join more than 30 other states that incentivize businesses to become compliant with unclaimed property laws through some form of a voluntary compliance program.

The VCP provisions of AB2280 become effective once appropriated by the Legislature during the annual budget process. At that point, the SCO is expected to adopt guidelines and forms that provide specific procedures for the administration of the program. As we note that AB2280 does not mandate, but rather permits the SCO to establish the VCP, it is unclear when the VCP will actually take effect and what, if any, additional elements may be added to the enrollment process. Accordingly, while the VCP will be a welcome development for financial institutions as one of the largest holders of unclaimed property, financial institutions cannot yet rely on the VCP for relief. We recommend that you engage SW&M to discuss how the VCP, the eligibility requirements, and the unknown implementation date may impact your financial institution.

2. AB1904: CLRA Covered Person

AB1904 requires financial service and product providers to clearly disclose in solicitations that the material is an advertisement and to include their name and contact information. Failure to do so is a violation of the Consumer Legal Remedies Act ("CLRA").

The CLRA was enacted "to protect the statute's beneficiaries from deceptive and unfair business practices," and to provide aggrieved consumers with "strong remedial provisions for violations of the statute."[85] The CLRA prohibits unfair methods of competition and unfair or deceptive acts or practices undertaken by any person in a transaction intended to result or which results in the sale or lease of goods or services to any consumer.[86] Consumers who are harmed by unlawful practices specified in the Act have a right of action under the CLRA to recover damages and other remedies, including actual damages; an order to enjoin the unlawful act; restitution; punitive damages; or any other relief that the court deems proper.[87] Additionally, the statute authorizes courts to award attorney's fees to prevailing plaintiffs and contains mechanisms for securing remedies on a class wide basis.[88] Consumers who are over the age of 65 are eligible to additionally seek and be awarded, in addition to the above remedies, up to $5,000 where the trier of fact finds certain circumstances are met.

The California Consumer Financial Protection Law ("CCFPL") (the existing law giving the California DFPI its consumer protection mandate) prohibits a covered person from engaging in unlawful, unfair, deceptive, or abusive practices. The DFPI is tasked with prescribing rules to ensure features of consumer financial products or services are accurately disclosed.[89] A "covered person" means, to the extent not preempted by federal law, any of the following: a) any person that engages in offering or providing a consumer financial product or service to a resident of this state; b) any affiliate of a person described in this subdivision if the affiliate acts as a service provider to the person; or c) any service provider to the extent that the person engages in the offering or provision of its own consumer financial product or service.[90] "Covered person" does not include those entities exempted from the CCFPL.

A "consumer financial product or service" means: a) a financial product or service that is delivered, offered, or provided for use by consumers primarily for personal, family, or household purposes; or b) a financial product or service that directly or indirectly brokers the offer or sale of a franchise in this state on behalf of another.[91]

AB1904 makes it unlawful, pursuant to the CLRA, to fail to include either of the following in a solicitation to a covered person, or an entity acting on behalf of a covered person, for a consumer financial product or service: a) the name of the covered person, and if applicable, the entity acting on behalf of the covered person, and relevant contact information, including a mailing address and telephone number; or b) the following disclosure statement in at least 18-point bold type and in the language in which the solicitation is drafted: **"THIS IS AN ADVERTISEMENT. YOU ARE NOT REQUIRED TO MAKE ANY PAYMENT OR TAKE ANY OTHER ACTION IN RESPONSE TO THIS OFFER."**

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[85] Am. Online, Inc. v. Superior Court, 90 Cal.App.4th 1, 11 (2001).
[86] Cal. Civ. Code § 1750 *et seq*.
[87] Cal. Civ. Code § 1780.
[88] Cal. Civ. Code §§ 1780, 1781.
[89] Cal. Fin. Code § 90000 *et seq*.
[90] Cal. Fin. Code § 90005(f).
[91] Cal. Fin. Code § 90005(e).

Financial institutions should carefully review marketing materials to ensure compliance with AB1904. Failure to do so may result in the steep penalties prescribed under the CLRA including attorney's fees for a prevailing plaintiff.

3. AB2766: Unfair Competition Law-Enforcement Powers-Investigatory Subpoena

Under the existing Unfair Competition Law, consumers have a statutory cause of action for unfair competition, including unfair and deceptive business practices or advertising. Currently, actions for relief under the UCL must be prosecuted by the Attorney General, a district attorney, or certain city attorneys or county counsels for cities with a population of more than 750,000. As the head of a department, the Government Code gives broad authority to the state Attorney General to conduct investigations regarding violations of law, including, among other things, the authority to inspect books and records, hear complaints, and, perhaps most importantly, issue subpoenas to compel witness testimony and or production of records that is pertinent or material to any inquiry, investigation, hearing proceeding, or action conducted in the state. This means that the Attorney General has the authority to issue subpoenas as a means of investigation in advance of any actual litigation being filed. Despite the fact that certain city attorneys or county counsels, along with district attorneys and the state Attorney General, are authorized to prosecute UCL claims, the UCL only authorizes district attorneys to exercise the investigatory powers reserved for the state Attorney General, including the all-important authority to issue pre-litigation subpoenas.

AB2766 amends existing law to grant those powers granted to the Attorney General as head of a department under the Government Code to 1) the city attorney of any city having a population in excess of 750,000, 2) the county counsel of any county within which a city has a population in excess of 750,000, or 3) a city attorney of a city and county, when the city attorney or county counsel reasonably believes that there has been a violation of the UCL. Effectively, this bill will strengthen the ability of certain local governments to investigate potential UCL violations. Primarily, AB2766, which takes effect on January 1, 2023, will have an impact on investigations conducted by city and county attorneys in the cities of Los Angeles, San Diego, San Jose, and San Francisco, along with the counties of Los Angeles, San Diego, Santa Clara, and San Francisco.

4. AB1802: Winding Up LLCs

The California Revised Uniform Limited Liability Company Act, authorizes managers or specified other persons, as applicable, to wind up the affairs of an LLC. Any assets inadvertently or otherwise omitted from the winding up continue in the canceled limited liability company for the benefit of the persons entitled to those assets upon cancellation, and, on realization, must be distributed accordingly.

SB1802 helps fill in the gaps as to what constitutes "distributed accordingly," and requires that omitted assets be used to discharge unsatisfied liabilities, if any, known to the company, with any excess be distributed to the members. Further, it explains who has the right to carry out the distribution of omitted assets, explaining that, if assets are omitted from the winding up, any person authorized to wind up the affairs of a limited liability company that has filed a certificate

of cancellation may use the assets to discharge the liabilities of the limited liability company and distribute any remaining assets to the members.

This isn't necessarily a groundbreaking bill, but does close some loopholes with respect to the winddown of LLCs, which can impact subsidiaries to financial institutions, including credit union CUSOs.

5. SB49: Corporate Conversions

Existing law specifies the process by which a corporation may be converted into a domestic other business entity if certain conditions are met. SB49 expands the application of this process to include (in addition to conversion to a domestic other business entity), conversion into a foreign other business entity or foreign corporation. The conditions for conversion themselves are substantively unchanged.

SB49 adds a new code section—Corporations Code § 1154—which provides certain enforcement rights:

(a) To enforce an obligation of a corporation that has converted to a foreign corporation or foreign other business entity, the Secretary of State shall only be the agent for service of process in an action or proceeding against that converted foreign entity, if the agent designated for the service of process for that entity is a natural person and cannot be found with due diligence or if the agent is a corporation and no person, to whom delivery may be made, may be located with due diligence, or if no agent has been designated and if none of the officers, members, managers, or agents of that entity may be located after diligent search, and it is shown by affidavit to the satisfaction of the court. The court then may make an order that service be made by personal delivery to the Secretary of State or to an assistant or Deputy Secretary of State of two copies of the process together with two copies of the order, and the order shall set forth an address to which the process shall be sent by the Secretary of State. Service in this manner is deemed complete on the 10th day after delivery of the process to the Secretary of State.

(b) Upon receipt of the process and order and the fee set forth in Government Code § 12197, the Secretary of State shall provide notice to that entity of the service of the process by forwarding by certified mail, return receipt requested, a copy of the process and order to the address specified in the order.

(c) The Secretary of State shall keep a record of all process served upon the Secretary of State and shall record the time of service and the Secretary of State's action with respect to the process served. The certificate of the Secretary of State, under the Secretary of State's official seal, certifying to the receipt of process, the providing of notice of process to that entity, and the forwarding of the process shall be competent and prima facie evidence of the matters stated therein.

6. AB2004: DREAM

The California DREAM Loan Program provides eligible undocumented AB540 undergraduates and graduates with the option to borrow loans to help cover the cost of a California State University. Currently, undocumented students who graduate from a California high school and meet the California Dream Act requirements are eligible for state and university aid, but ineligible for federal aid (including federal loans). The DREAM loan program, funded by the state and the state university system, attempts to close that gap and provide eligible students with the opportunity to borrow student loans to help pay for their education.

Prior to AB2004, students were prohibited from borrowing more than $20,000 in the aggregate under the program from any one participating institution. SB2004 has increased that cap to $40,000.00, although there is still a limitation applied separately for undergraduate and graduate programs, and that limit is $20,000.00 for each.

Further, AB2004 requires participating institutions to, on or before January 1, 2024, establish DREAM loan forgiveness options for borrowers with similar standards as those set forth in the Federal Perkins Loan Program.

It is not clear whether this will impact financial institutions except in the sense a financial institution may act as a disbursing agent for an educational institution offering these loans.

7. AB1632: Restroom Access – Medical Conditions

AB1632 requires businesses that have toilet facilities for employees, under certain conditions, to allow individuals with certain health conditions to access them even if they are not normally available to the general public.

Specifically, AB1632 applies to businesses that are open to the general public for the sale of goods (i.e. retail establishments) and access is required only if certain conditions are met, including among others, that the individual requesting access has a specified medical condition, a public restroom is not immediately accessible and that the use of the employee toilet facility would not create an obvious health or safety risk to the individual. The business may also require that that the individual present reasonable evidence of the medical condition.

While AB1632 does not apply to financial institutions, it follows a current trend among other states that started in Illinois with *The Restroom Access Act* (also known as Ally's Law) to provide access to toilet facilities to individuals with ostomy bags or inflammatory bowel diseases such as Crohn's disease and irritable bowel syndrome that can cause frequent and/or urgent bowel movements to prevent public accidents and humiliation.

8. SB1242: Insurance Committee

SB 1242 is an omnibus bill that covers a variety of unrelated topics under a single piece of legislation, including insurance fraud reporting and education mandates, fingerprinting and licensing disclosures.

Beginning January 1, 2023 insurance agents and brokers will be required to report fraud to the California Department of Insurance (the "CDI"). More specifically, SB1242 amends the California Insurance Code to require producers who suspect or know a fraudulent application for insurance is being made to submit to the DOI Fraud Division information regarding the factual circumstances of a suspicious application and the alleged misrepresentations it contains via the electronic Consumer Fraud Reporting Portal information within 60 days of determining fraud has or may have occurred. Furthermore, where suspected or known fraud is discovered after an application has been placed with a carrier, the producer will be obligated to report it to the special investigation unit of the impacted insurer. The producer will be required to provide all documents and evidence that the unit may later request.

Previously, only carriers were subject to fraud reporting requirements. These producer reporting obligations are entirely new. Therefore, agents and brokers should not turn a blind eye to fraudulent conduct by an insurance applicant. SB1242 creates regulatory exposure for failing to comply with the law. Producers who fulfill their duties by reporting fraud or assisting with related investigations are insulated from civil liability, assuming they have acted in good faith.

In addition, commencing on March 1, 2023, producers will have to complete one (1) hour of study on insurance fraud to complete their continuing education requirements. However, the education requirement on insurance fraud will be part of the hourly requirement for ethics training, meaning the total number of continuing education hours will remain unchanged.

SB1242 also amends the California Insurance Code to compel the insurance commissioner to submit fingerprint images and related information that pertains to applicants for licensing to the California DOJ. These fingerprints are used to conduct background checks including uncovering criminal convictions. Applicants who fail to disclose criminal convictions on a license application may have their applications denied. Consequently, applicants should ensure their complete criminal history is disclosed on their individual license application before submission.

Under current law, producers are required to include their license numbers on business cards, premium quotes and print advertisements for insurance products distributed exclusively in California. Beginning on January 1, 2023, all producers conducting business in California will need to include their license number in emails involving the transaction of insurance. The license number must be presented in a font no smaller than the largest telephone number, street address or producer email address appearing on a given email and must be located adjacent to or on the line below an agent or broker's name or title. Similarly, the license number of an organizational licensee is to be set forth adjacent to or on the line below the organization's name.

Financial institutions can ensure their insurance producers and/or partners are adhering to the above standards by reviewing their third-party agreements to confirm they contain contractual provisions requiring compliance with all applicable laws, statutes, and regulations.

9. <u>SB63: Consumer Credit Contracts: Notice to Cosigner and Translation Requirements</u>

SB633 requires a statutorily prescribed notice to be provided on a separate sheet to prospective cosigners of consumer credit contracts and vehicle leases before they sign said agreements. Under current law, said cosigner notice is required to be presented to prospective cosigners in English and Spanish; however, SB633 also requires that the statutorily prescribed notice be presented in Chinese, Tagalog, Vietnamese, and Korean, in addition to English and Spanish. SB633 also deletes an existing provision in the current law that allows creditors and lessors not to provide the statutorily required notice to prospective cosigners who are married to prospective signers.

As stated, SB633 relates to a consumer credit contract, which is defined as any of the following obligations to pay money on a deferred basis, if the money, property, services, or other consideration provided for in the contract is primarily for personal, family, or household purposes: (i) Retail installment contracts and accounts, as defined under the Unruh Act; (ii) Conditional sales contracts, as defined under the Automobile Sales Finance Act.; (iii) Loans or extensions of credit for use primarily for personal, family, or household purposes, whether unsecured or secured by collateral other than real property; (iv) Loans or extensions of credit for use primarily for personal, family, or household purposes, whether secured by real property or not, that are regulated under the Real Estate Law in the Business and Professions Code or the California Financing Law in the Financial Code; and (v) Vehicle leases, as defined under the Motor Vehicle Leasing Act.[92]

Based on the foregoing, financial institutions must be sure to provide the statutorily prescribed notice to all co-signers of consumer credit contracts (as defined above) prior to them signing the underlying contract, whether or not married to the prospective signers. In addition, said cosigner notice must also be provided in all six languages stated in SB 633 (English, Spanish, Chinese, Tagalog, Vietnamese, and Korean). Notably, SB633 also requires the DFPI to make the statutorily prescribed notice available, including a translation in all six languages.

Importantly, SB633 will make the failure to provide the required translations an affirmative defense to an action to enforce the underlying consumer credit contract, which means that in a collection action against a cosigner, a lender's failure to provide the required translated notices may preclude the lender from being able to collect from the cosigner. As such, financial institutions must ensure that they are incorporating the requisite cosigner notice, in all six languages (provided by the DFPI), as part of their consumer credit contract documents.

The changes made in SB633 appear to align with the DFPI's and other regulators' goals of seeking to further assist consumers with limited English proficiency. Given the growing population of consumers with limited English proficiency, financial institutions should anticipate further changes regarding offering financial products to these consumers.

Having said that, and in light of SB633, financial institutions that do business in California should be reminded of the California Translation Act, which was passed "to increase consumer information and protections for the state's sizeable and growing Spanish-speaking population,"

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[92] *See* Cal. Civ. Code § 1799.90(a).

as well as other non-English speaking residents.[93] The Act provides, in pertinent part: "any person engaged in a trade or business who negotiates primarily in Spanish, Chinese, Tagalog, Vietnamese, or Korean, orally or in writing, in the course of entering into any [of a list of contracts, included in the statute itself], shall deliver to the other party to the contract or agreement and prior to the execution thereof, a translation of the contract or agreement in the language in which the contract or agreement was negotiated, that includes a translation of every term and condition in that contract or agreement."[94] As such, if a financial institution negotiates a covered contract or agreement in Spanish, Chinese, Tagalog, Vietnamese, or Korean, it must be mindful of the requirements under the Act, which generally require the financial institution to provide a translation of the related contract/agreement in the corresponding language.

10. AB2961: Electronic Service

Electronic service of certain documents by a court was previously predicated upon, among other things, prior consent to electronic service by the party receiving notice (or electronic service has been ordered by the court). As of July 1, 2024, AB2961 authorizes a court to order electronic service on a person represented by counsel who has appeared in an action or proceeding, thus eliminating the condition that they first consent to electronic service. A person represented by counsel, who has appeared in an action or proceeding, will be required to accept electronic service of a notice or document that may be served by mail, express mail, overnight delivery, or facsimile transmission. This is much more consistent with service rules in federal court as they relate to electronic service (*i.e.*, there, one a party has electronically filed a document, the court serves them with electronic notice of all other filed documents). Although there are other components of AB2961, none are particularly relevant to financial institutions.

11. AB1633: Protective Proceedings

Under the existing California Guardianship-Conservatorship law, conservators are appointed by the court and granted various powers based on the requirements set forth in the California Probate Code. As part of the appointment process, the court is directed by the Probate Code to grant a conservatorship only where it makes an express finding that granting the conservatorship is the least restrictive alternative needed for protection of the conservatee. In a fairly significant attempt to reform aspects of the conservatorship process, the Legislature passed AB1663, known as the Probate Conservatorship Reform and Supported Decision-Making Act.

One of the more significant aspects of AB1663 is the introduction of "supported decisionmaking [sic] agreements." In general, a supported decisionmaking agreement is a voluntary, written agreement between an adult with a disability and one or more supporters of the adult. The agreement will list those areas where the adult with the disability is requesting support and a list of areas where the supporter agrees to support the adult with disability. The supporter must also confirm their eligibility under the statute to serve as a supporter. For example, persons against whom an allegation of elder abuse has been made or an order of protection has been issued with respect to the adult with the disability, or persons that are the subject of a civil or criminal order prohibiting contact with the adult with the disability, or that have been removed as conservator

[93] *See* Cal. Civ. Code § 1632(a).
[94] *See* Cal. Civ. Code § 1632(b).

for the adult based on a finding that they did not act in the conservatee's best interests are similarly ineligible. A supported decisionmaking agreement must be signed by the adult with the disability and each supporter in the presence of two disinterested witnesses at least 18 years old, or a notary public.

In reviewing petitions for conservatorships and determining whether a conservatorship is the least restrictive alternative needed to protect the conservatee, AB1663 requires the court to specifically consider the person's current abilities and capacities with current and possible supports, including, among other things, the use of supported decisionmaking agreements and powers of attorney. Certain persons that petition to be conservators will also be required to tell the court why alternatives to the conservatorship, such as powers of attorney and supported decisionmaking agreements, are not suitable.

It is important to note that a supported decisionmaking agreement does not replace traditional legal documents like a power of attorney or representative payee agreements. Supporters under a supported decisionmaking agreement are specifically prohibited from making decisions or signing documents on behalf of an adult with a disability unless the supporter has a valid legal authorization and is acting within the scope of that authorization. However, given the formalities of the document as established by AB1663, we would not be surprised to see adults with disabilities and their supporters attempt to use these types of documents to delegate authority in a manner similar to POAs. Financial institutions should be prepared to see a potential influx of these supported decisionmaking agreements and understand their scope to ensure that they are not inappropriately granting access to member accounts without proper documentation.