



California Licensing Requirements for Unregulated Lenders and Intermediaries

Michael J. Zerman



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Michael Zerman is a Partner at Zuber Lawler & Del Duca LLP in Los Angeles. His practice concentrates on real estate lending, leasing, and purchase and sale transactions for public and private companies, financial institutions, pension funds, and government entities.

I. Introduction

For much of the last century, real estate lenders were most often regulated financial institutions, such as commercial banks, savings and loan associations, and insurance companies, or regulated pension funds, which held exempt status under California's lender and broker licensing laws. Intermediaries, who introduced borrowers to lenders and helped to negotiate the loan terms, were called brokers, and they understood that real estate licenses were required to conduct their trade. Today the roles assigned to those engaged in real estate lending contain many grey areas. For example, private lenders and crowdfunding enterprises frequently create a new entity in order to lend funds on a transaction or a pool of transactions, and then create another entity to receive an origination fee or to service the loan(s).

II. The California Finance Lenders Law

The California Finance Lenders Law¹ governs lenders and brokers engaged in the business of making or negotiating "consumer loans" or "commercial loans."

Consumer loans are defined to include most loans where the borrower uses the proceeds for personal, family, or household purposes.² Commercial loans are defined to include most loans for amounts greater than \$5,000, whether secured or unsecured, where the borrower does not use the proceeds for personal, family, or household purposes.³ No person may participate as a lender or broker of consumer loans or commercial loans in California without obtaining a license from the California Commissioner of Business Oversight.⁴ Out-of-state lenders that make loans to California residents must be licensed in California as finance lenders.⁵ The process to obtain a license can take between six to twelve months or longer. Anyone who willfully violates the Finance Lenders Law may face fines of up to \$10,000 and/or imprisonment for a one-year term.⁶

A. Exemptions

The California Finance Lenders Law provides that certain entities, persons, and transactions are exempt from the general licensing requirements. Exempt categories include:

1. banks, savings and loan associations, credit unions, certain SBA-approved lenders, and pawnbrokers regulated by the laws of any state or by federal law;⁷
2. licensed check cashers;⁸
3. colleges and universities making student loans;⁹
4. securities broker-dealers licensed under California law;¹⁰

5. persons or entities who make no more than five (5) commercial loans in a twelve-month period, and the loans are “incidental” to the primary business of the person relying on the exemption;¹¹
6. certain public entities (including municipal corporations and government agencies);¹²
7. agricultural cooperatives;¹³
8. certain credit card issuers;¹⁴
9. loans made or arranged by California-licensed real estate brokers and secured by a lien on real property;¹⁵
10. cemetery brokers;¹⁶
11. licensed “residential mortgage lenders;”¹⁷
12. commercial bridge loans made by a venture capital company to an operating company;¹⁸
13. franchise loans made by a franchisor to a franchisee;¹⁹ and
14. certain commercial loans and other investments made by certain tax-exempt organizations.²⁰

B. Limitations of Exemptions

Many lenders do not fit neatly into any of the foregoing exempt categories. For example, an investment banking firm may be an exempt securities dealer under the Finance Lenders Law, but the applicable exemption would not extend to a single-purpose entity that the investment bank forms to fund one or more specific loans. A crowdfunding enterprise could claim an exemption if it does not make more than five commercial loans in a twelve-month period, but only if its lending activities are incidental to its primary business. Therefore, its primary business cannot be real estate lending. Furthermore, this exemption probably would not apply if such loans were funded by a single-purpose entity that has no other primary business.

In the absence of any exemptions, unlicensed entities or persons risk being fined and/or imprisoned for non-compliance with the Finance Lenders Law. When faced with this dilemma, many lenders first seek to obtain a license under either the Finance Lenders Law or the California Real Estate Regulations (as discussed in Section III), because each statute contains an exemption for licensees under the other statute.

C. Application Requirements

The application fee for a California Finance Lender’s license is a total of \$300, which is non-refundable.²¹ The applicant must file an application with the Department of Business Oversight, which contains responses to eleven multi-part questions and thirteen exhibits with information about the applicant,²² including financial statements prepared according to generally accepted accounting principles that demonstrate a net worth in excess of \$25,000.²³ The application’s “Execution Section” requires applicants to make thirty-three declarations about the applicant’s business operations under penalty of perjury.²⁴ After an application is submitted, the Commissioner of Business Oversight investigates the applicant’s principal officers, directors, and any persons who own or control more than ten percent of the applicant, to determine whether any of them have committed a crime or fraudulent act within the past ten years.²⁵ If an entity owns or controls more than ten percent of the applicant, then additional questionnaires and fingerprints must be submitted for each officer, director, general partner, or managing member of the owning or controlling entity.²⁶ However, the Commissioner of Business Oversight may waive this requirement if the Department determines that further investigation is not necessary for public protection.²⁷

Applicants must file a \$25,000 surety bond with the Commissioner of Business Oversight together with the other application materials.²⁸ This surety bond must be maintained at all times after the license is issued.²⁹ Licensees that operate from more than one business location must apply for an additional branch office license for each location,³⁰ but only one surety bond is required for all locations.³¹

Licensees must preserve their books, accounts, and records for at least three years for inspection by the Commissioner of Business Oversight.³² Any licensee located outside of California must also agree to make its books, accounts, papers, records, and files available to the Commissioner of Business Oversight at a designated location in California within ten days after any request by the Commissioner, or to pay the reasonable travel expenses, meals, and lodging incurred by the Commissioner or its representatives during any investigation or examination made at the licensee’s location outside of California.³³ Licensees are also subject to certain restrictions on advertising,³⁴ and all advertisements (whether printed or oral) must include the license under which the loan would be made or arranged.³⁵

Once approved, a finance lender's license remains in effect indefinitely until it is surrendered, revoked, or suspended.³⁶

D. Limitations on Licensees

Holding a finance lender's license may not accomplish all of the objectives that the licensee intended. A finance lender's license only allows a lender to make consumer or commercial loans, or a broker to negotiate and perform other broker services *in connection with loans made by other finance lenders*.³⁷ A finance lender's license does not entitle the licensee to perform broker services for most regulated financial institutions because although banks, savings and loan associations, and licensed broker-dealers are *exempt* from the Finance Lenders Law, they are not deemed to be *licensed* entities. Further, a finance lender's license does not entitle the licensee to perform broker services for unregulated lenders or borrowers that do not possess a finance lender's license, including any affiliated entities that are unlicensed. Therefore, even if one entity is a licensed finance lender, it will be unable to accept broker commissions from an affiliated fund that is not a licensed finance lender. These limitations present a problem for many private loan funds, which typically form separate legal entities for each fund.

Moreover, a licensed finance lender may not sell promissory notes evidencing any loans made by the licensee or purchased from another licensee, except to certain "institutional investors," which includes government agencies, regulated banks and insurance companies, large pension funds, public corporations, and other finance lenders.³⁸ The Finance Lenders Law generally precludes licensees from selling notes to affiliated entities or funds that are not licensed finance lenders.³⁹ Therefore, private loan funds cannot originate loans through a licensed entity and then sell such loans to an affiliated entity that is unlicensed. Instead, most private loan funds must obtain a separate finance lender's license for each fund, even though the application process can take six to twelve months (or longer) for each license.

III. The California Real Estate Regulations

In order to lawfully engage in real estate broker activities, most lenders, whether licensed, unlicensed, or exempt under the California Finance Lenders Law, must comply with the California Real Estate Regulations ("Regulations").⁴⁰ The Regulations provide that it is unlawful for any person to engage in the business of, act in the capacity of, advertise as or assume to act as a "real estate broker" or a "real estate salesperson" within the State of California without first obtaining a real estate license from the California Bureau

of Real Estate.⁴¹ Anyone who fails to comply with these regulations could be imprisoned for a six-month term and/or be punished by a fine of up to \$60,000, in addition to having his, her, or its real estate license suspended or revoked.⁴²

The statute defines a "real estate broker" to include any person who "... for compensation or in expectation of compensation, regardless of the form or time of payment ... solicits borrowers or lenders or negotiates loans or collects payments or performs services for borrowers or lenders or note owners in connection with loans secured directly or collaterally by liens on real property or on a business opportunity ..."⁴³ or "... engages as a principal in the business of making loans or buying from, selling to, or exchanging with the public ... notes secured directly or collaterally by liens on real property...."⁴⁴

A real estate salesperson is defined as "a natural person who, for compensation or in expectation of compensation, is employed by a licensed real estate broker to do one or more of the acts ... [requiring a broker's license]."⁴⁵

A. Corporate Broker Licenses and Their Limitations

The Regulations permit a corporation to be licensed as a real estate broker.⁴⁶ However, if the licensee is a corporation, the license entitles only *one* officer thereof to engage in the business of real estate brokering on behalf of the corporation.⁴⁷ This officer must be designated in the corporation's application for a license.⁴⁸ If a licensed corporation desires any of its officers other than the designated officer to act as a real estate broker under the corporation's license, then the corporation must procure an additional license for each of such additional officers.⁴⁹

A real estate license entitles only one designated corporate officer to solicit borrowers or lenders, negotiate loans, or service loans for third parties. Although the Regulations make an exception for clerical workers,⁵⁰ any other employees or officers who solicit borrowers or lenders, or negotiate the terms of loans, or service loans, must do so under separate licenses, either as a real estate broker or a real estate salesperson. In the absence of any exemptions, this requirement would impose great administrative burdens on many lending institutions, where multiple employees perform broker-related activities, often in several states. A corporation may obtain additional real estate broker licenses, but for each license an officer of the corporation must pass a written examination in the same manner as if applying for an individual broker's license.⁵¹ In contrast to a real estate broker, a real estate salesperson must be a

natural person. Therefore, a corporation cannot obtain a salesperson's license on behalf of its employees. In addition, the Regulations require a licensed real estate broker to procure an additional license for each separate place of business within the State of California.⁵² Ordinarily, a real estate license may only be used in the single location that is designated in the license.⁵³ Therefore, a licensed broker must obtain additional real estate licenses for each branch location where broker services are offered, even if the branches are located in the same city or county.

B. Exemptions

Without any exemptions, the licensing provisions of the Regulations would impose a great administrative burden upon many large financial institutions. However, the Regulations exempt certain entities or persons from the general licensing requirements, including the following:

1. banks, savings and loan associations, pension trusts, insurance companies and credit unions regulated by the laws of any state or by federal law, and their employees;
2. agricultural cooperatives and regulated agricultural loan companies;
3. licensed attorneys when rendering legal services to a client;
4. licensed finance lenders acting under the authority of a finance lender's license;
5. cemetery authorities;
6. persons authorized by a savings institution to act as an agent of that institution, when acting under the scope of that authorization;
7. licensed securities brokers and securities dealers, and their employees, in connection with the purchase and sale of mortgage-backed securities; and
8. licensed "residential mortgage lenders" acting under the authority of that license.⁵⁴

C. Limitations of Exemptions

Many lenders and intermediaries do not fit neatly into any of the exempt categories listed above. For example, securities dealers are only exempt in the limited context of the sale of mortgage-backed securities. Moreover, this limited exemption would not extend to a separate entity that a securities dealer creates to fund one or more specific loans,

or to receive origination fees on those loans. As discussed in Section II.D. above, the exemption for a licensed finance lender does not allow a finance lender to perform most real estate broker services, other than those services performed in connection with a loan made by another finance lender.⁵⁵

D. Exception for Finders and Middlemen

There is an exception to the broker license requirements for the payment of compensation to a mere "finder" or "middleman." A person who merely introduces a prospective borrower or lender is not performing an activity that requires a license. This "finder" is not considered to be acting as the agent for either party to a transaction as long as the finder does not participate in the loan negotiations in any way, not even incidentally. An agreement to compensate a finder as consideration for facilitating an introduction is enforceable by the finder regardless of whether the finder is licensed.⁵⁶ This exception does not apply if the finder performs any act that would require a license, regardless of how minor or incidental the act may be.⁵⁷ A broker or salesperson who pays a "finder's fee" to a non-licensee, or to a salesperson who is not employed by the broker paying the fee, would violate the Regulations if the alleged finder performed *any* act requiring a real estate license.⁵⁸ Actions that may require a license include participating in loan negotiations, showing properties to lenders, or assisting a borrower in preparing a loan application.⁵⁹ A licensee is always at risk when paying any fee or compensation to a person who does not hold a license due to the difficulty in determining whether the recipient has crossed the narrow line between a finder and an agent.

E. Out-of-State Brokers

A licensed California real estate broker may pay a commission to a broker licensed in another state.⁶⁰ Whether an out-of-state broker, who is not licensed in California, can recover a commission in a California court is not determined by the location of the real property, but by the location in which the broker performed the services that require a license. A California license is only required when an out-of-state broker performs activities within California that require a license, such as meeting with potential lenders or borrowers within California in order to solicit business or negotiate loan terms, showing real property within the state to prospective lenders, or inspecting California properties on behalf of a lender or borrower.⁶¹ When an out-of-state broker performs these types of acts in California, he cannot recover compensation.⁶² However, even when the borrower, lender, or real property is located within California, if the out-of-state broker does not perform any act within

California that requires a license, then he can recover a commission for services performed outside of California, as long as he held the appropriate license in the state where he performed the services.⁶³

Despite the foregoing exceptions, an out-of-state broker must still comply with the California Finance Lenders Law if the broker makes loans to California residents.⁶⁴ The exemption under that law for licensed real estate brokers only applies to California licensees.⁶⁵

IV. Conclusion

Due to the complexity of California's lender and broker licensing requirements, most unregulated lenders should understand these licensing rules before engaging in real estate lending or intermediary activities within the state.

Endnotes

- 1 Cal. Fin. Code §§ 22000–780.
- 2 *Id.* §§ 22203, 22204.
- 3 *Id.* § 22502.
- 4 *Id.* § 22100. Certain additional rules apply to licensees engaged in the business of making or brokering residential mortgage loans. *See id.* §§ 22100(b), 22100(e). However, this article will focus solely on the origination and brokerage of loans secured by commercial real estate.
- 5 *People v. Fairfax Family Fund, Inc.*, 235 Cal. App. 2d 881 (1964).
- 6 Cal. Fin. Code §§ 22753, 22780.
- 7 *Id.* § 22050(a).
- 8 *Id.* § 22050(b).
- 9 *Id.* § 22050(c).
- 10 *Id.* § 22050(d).
- 11 *Id.* § 22050(e).
- 12 Cal. Fin. Code § 22050(f).
- 13 *Id.* § 22051.
- 14 *Id.* § 22052.
- 15 *Id.* § 22057.
- 16 *Id.* § 22058.
- 17 *Id.* § 22060.
- 18 Cal. Fin. Code § 22062.
- 19 *Id.* § 22063.
- 20 *Id.* § 22064.
- 21 *Id.* § 22103.
- 22 Cal. Code Regs. tit. 10, § 1422.
- 23 Cal. Fin. Code § 22104. All licensees must maintain this \$25,000 net worth at all times. *See id.* § 22104(a). Licensees that arrange, but do not make, residential mortgage loans must maintain a net worth of at least \$50,000.

See id. § 22104(c). Licensees that make residential mortgage loans must maintain a net worth of at least \$250,000. *See id.* § 22104(b).

- 24 Cal. Code Regs. tit. 10, § 1422, execution sec.
- 25 Cal. Fin. Code §§ 22105, 22109.
- 26 Cal. Code Regs. tit. 10, § 1422, exhibit C.
- 27 *Id.*
- 28 *Id.* at exhibit B.
- 29 Cal. Fin. Code § 22112.
- 30 *Id.* §§ 22102, 22152.
- 31 *Id.* § 22112.
- 32 *Id.* §§ 22156, 22157; Cal. Code Regs. tit. 10, § 1425.
- 33 Cal. Code Regs. tit. 10, § 1422 execution sec. subdiv. 26.
- 34 Cal. Fin. Code §§ 22161, 22162, 22165, 22166.
- 35 *Id.* § 22162.
- 36 *Id.* § 22700(a).
- 37 *Id.* §§ 22004, 22059.
- 38 *Id.* § 22600.
- 39 *Id.*
- 40 Cal. Bus. & Prof. Code § 10130–249.93.
- 41 *Id.* § 10130.
- 42 *Id.* §§ 10138, 10139, 10165.
- 43 *Id.* § 10131.
- 44 *Id.* § 10131.1.
- 45 *Id.* § 10132.
- 46 Cal. Bus. & Prof. Code §§ 10006, 10150(b), 10211.
- 47 *Id.* § 10211.
- 48 *Id.*
- 49 *Id.* § 10158.
- 50 *Id.* § 10133.2.
- 51 *Id.* §§ 10153, 10150.
- 52 Cal. Bus. & Prof. Code § 10163.
- 53 *Id.* § 10162.
- 54 *Id.* § 10133.1(a).
- 55 Cal. Fin. Code §§ 22004, 22059.
- 56 *Tyrone v. Kelley*, 9 Cal. 3d 1 (1973); *Queen of Angels Hosp. v. Younger*, 66 Cal. App. 3d 359 (1977).
- 57 *Tyrone*, 9 Cal. 3d at 9; *McConnell v. Cowan*, 44 Cal. 2d 805, 811 (1955).
- 58 Cal. Bus. & Prof. Code § 10138.
- 59 *Id.* § 10131.
- 60 *Id.* § 10137.
- 61 *Id.* § 10131.
- 62 *Consul Ltd. v. Solide Enters., Inc.*, 802 F.2d 1143, 1149 (9th Cir. 1986).
- 63 *Id.* at 1149–51.
- 64 *People v. Fairfax Family Fund, Inc.*, 235 Cal. App. 2d 881 (1964).
- 65 Cal. Fin. Code § 22057.