

Date of Hearing: April 23, 2012

ASSEMBLY COMMITTEE ON BANKING AND FINANCE
Mike Eng, Chair
AB 1980 (Hernandez) – As Amended: March 29, 2012

SUBJECT: Loans: disclosures: financial facts label.

SUMMARY: Requires, that on or after January 1, 2014 licensees under the California Finance Lenders Law (CFL) and the Deferred Deposit Transaction Law (DDTL) provide a financial facts label accompanying every window advertisement, online advertisement, mailer, flier, brochure or pamphlet. Specifically, this bill:

- 1) Requires that prior to the consummation of a California Finance Lender (CFL) loan or a payday loan that the licensee provide the borrower with the financial facts label disclosure.
- 2) Provides that the financial facts label shall include all of the following information:
 - a) The amount and the number of payments for the loan;
 - b) The average amount per payment;
 - c) A "Percent of Monthly Debt Budget" caption to inform the consumer of how loan payments will affect his or her debt budget and cash flow. Requires that this caption also include a disclosure stating, "Percent of Monthly Debt Budget value is based on the loan payment divided by the recommended consumer debt-to-income ratio of 15 percent, using a \$3,000 after-tax monthly income level. Debt budget will vary according to your income level.";
 - d) A breakdown of the monthly payment indicating how much will be paid towards the principal, loan fees, and interest;
 - e) The annual percentage rate (APR);
 - f) The interest rate used to calculate the loan payments;
 - g) Total monthly fees to be paid on the loan;
 - h) Total monthly payment; and,
 - i) Late payment amount.
- 3) Requires the Department of Corporations (DOC) to adopt regulations, by January 1, 2014 to set forth the design of the label based upon the design of the federal Food and Drug Administration's nutritional facts label.
- 4) Makes various legislative findings and declarations.
- 5) Sunsets the requirements to offer the label January 1, 2018.

EXISTING LAW

The CFLL applies to lenders who make consumer or commercial loans, whether unsecured or secured by real or personal property or both, to consumers for use primarily for personal, family, or household purposes. The CFLL is regulated by the DOC. The CFLL is in the California Financial Code, Division 9, commencing with Section 22000. The regulations under the CFLL are contained in Chapter 3, Title 10 of the California Code of Regulations, commencing with Section 1404 (10 C.C.R. §1404, et seq.).

The CFLL was enacted by the California legislature effective on July 1, 1995 and consolidated and replaced the Personal Property Brokers Law, the CFLL and the Commercial Finance Lenders Law which were previously applicable to personal property brokers, consumer finance lenders, and commercial finance lenders. Even though the CFLL is a relatively recent statute, it is based upon previous statutes.

According to the DOC, Finance lenders and brokers, by number of licensees and dollars of loans originated, are the largest group of financial service providers regulated by DOC. A finance lenders license provides the licensee with an exemption from the usury provision of the California Constitution. Licensed under the law are individuals, partnerships, associations, limited liability companies and corporations. The law requires applicants to have and maintain a minimum net worth of at least \$25,000 and to obtain and maintain a \$25,000 surety bond. In general, principals of the company may not have a criminal history or a history of non-compliance with regulatory requirements.

In addition to the lending authority provided by the law, the CFLL provides limited brokering authority. A "broker" is defined in the law as "any person engaged in the business of negotiating or performing any act as broker in connection with loans made by a finance lender." Brokers licensed under this law may only broker loans to lenders that hold a CFL license.

Several entities are not required to be licensed under the CFLL, including banks and savings and loan associations, credit unions, mortgage lenders, licensed check cashers, licensed pawn brokers or those licensed under the DDTL. "Non-loan" transactions, such as bona fide leases automobile sales finance contracts and retail installment sales are also not subject to the provisions of the CFLL.

If a business makes a one-time loan, then the business can rely on the safe harbor of no more than one loan in a 12-month period. However, where the safe harbor and other exemptions under the CFLL do not apply, then the business may need to apply for a license under the CFLL. Violating the CFLL can result in penalties of \$2,500 for each violation, imprisonment (for not more than one year), or both, and willful violations can also be punished by a fine of \$10,000 in addition to imprisonment (for not more than one year) or both.

CFL licensees constitute a class of “exempt persons” for purposes of California’s constitutional usury limitations (Cal. Fin. Code § 22002).

Additionally, DOC licenses and regulates the DDTL, commencing with Financial code Section 2300. A Deferred Deposit Transaction (DDT), commonly referred to as payday loan, is a short-term loan in which a borrower writes a post-dated, personal check to a lender for a specified amount, capped at \$300. The date on the check is the date on which the parties agree that the borrower will repay the loan. The lender advances the borrower the amount on the check, less the fee, which is also capped by law. The lender does not cash the check at the time the loan is made. The lender and the borrower are aware that the borrower lacks sufficient funds to cover the check at the time the check is written. The assumption underlying the loan is that the borrower will repay the loan by the agreed-upon date, either by depositing sufficient funds in his or her checking account to cover the check, or by paying the lender in cash on the loan’s due date, and having the lender return the original check to the borrower, without cashing it.

California enacted its earliest version of a payday lending law in 1996, and gave jurisdiction over payday lenders to the Department of Justice (DOJ; SB 1959, Calderon, Chapter 682, Statutes of 1996). SB 898 (Perata, Chapter 777, Statutes of 2002), enacted the CDDTL; and shifted the responsibility for administering payday lending from DOJ to the DOC.

FISCAL EFFECT: Unknown

COMMENTS:

According to information provided by the author's office this bill is necessary for the following reasons:

The Financial Facts Label Act of 2012 would provide clear and transparent consumer disclosures on small dollar loans (\$2,500 or under). The Financial Facts label provides a consumer-friendly disclosure that both small-dollar lenders and advocates can support. Low-income consumers who rely on small-dollar loans to make ends meet need clear and transparent disclosures; lenders need consumers who can afford to pay back their loans. The Financial Facts label presents key loan terms: the total amount, number and amount of monthly payments and fees, annual percentage rate, late payment fee, and total cost. With distilled loan information, borrowers can better assess for themselves, at the moment of decision, whether they can afford to take out a loan. Likewise, lenders can be more assured that borrowers are considering their ability to repay a loan before committing. The Financial Facts label presents factual information that provides both consumers and lenders with a tool for improving the small-dollar loan landscape in California.

This bill sponsored by Mission Asset Fund (MAF), a non-profit organization in San Francisco, is the result of an experiment, conducted in 2010, regarding loan disclosure documents. This project involved an analysis of the costs of borrowing \$1,000 in San Francisco's Mission District. MAF sought this information from 57 different financial entities. After collecting the information, MAF designed a financial facts label and then set about to conduct a test to determine the benefit of the label. In October 2011 seventy four participants were provided with original loan documents and the financial facts label information for the same loan products. MAF found that only 23% of respondents correctly determined the monthly payment amount

from the original loan documents. In contrast, consumers correctly determined the loan payment from the financial facts label 80% of the time. MAF concluded in their report on the study, *Just the financial facts, please! A Secret Survey of Financial Services in San Francisco’s Mission District*, the following:

Our survey illustrated not only the complexity of the marketplace, but also the futility of labeling a set of lenders as predatory –or bad lenders– to alert clients to steer clear. We realized that the only strategy with a lasting impact is one that increases a borrower’s ability to assess lenders and loan products independently. The Financial Facts labels and the Responsible Lending and Borrowing Checklist are designed to aid consumers in their quest for affordable and responsible loans. The Financial Facts labels provide consumer loan information in a clear, transparent and easy to understand format. The Responsible Lending and Borrowing Checklist guides borrowers through a set of questions about lenders, loans, and their own financial circumstances in order to assess whether they can afford to take out new loans.

It is our hope that this report will ignite a deeper conversation with advocates in the asset-building field, bank-on initiatives, and other thought leaders to advocate for a standardized, easy-to read and easy-to-access format for disclosing critical information on installment loans, transactional products, and other consumer financial products.

Sample Financial Facts Label:

The amount and the number of payments for the loan are stated here

Loan payments are averaged to illustrate how monthly payments are allocated between principal, fees and interest

The monthly payment is broken down to demonstrate how much is paid towards the principal, loan fees, and interest

The annual percentage rate (APR) is the annualized total cost of the loan that includes interest and total fees

The interest rate used to calculate the loan payments

The “% of Monthly Debt Budget” metric informs the borrower of how loan payments will affect their debt budget and cash flow

Indicates the portion of the monthly debt budget used by loan payment

Total fees plus total interest equals the total cost of the loan

Total paid equals the total cost of the loan plus the principal

The debt-to-income ratio uses an after-tax monthly income of \$3,000 which is about 70% of the U.S. median monthly household income

Financial Facts	
Loan amount \$1,000	18 monthly payments
Average Amount Per Payment	
Principal \$55	Fees & Interest \$7
% of Monthly Debt Budget *	
Monthly Payment \$62	14%
Principal \$55	
Loan Fees \$3	
Interest \$4	
APR 14%	Total Fees \$50
Interest Rate 8%	Total Interest \$68
Late Payment \$15	Total Paid \$1,118
* Percent of Monthly Debt Budget value is based on the loan payment divided by the recommended consumer debt-to-income ratio of 15 percent, using a \$3,000 after-tax monthly income level. Debt budget will vary according to your income level.	
Income levels: \$2,000	\$3,000 \$4,000 \$5,000 \$6,000
Debt budget: \$300	\$450 \$600 \$750 \$900
Numbers rounded to nearest dollar.	

Discussion.

The concept of requiring a simplified loan disclosure is not new. Federal and state regulators, consumer organizations and other stakeholders have struggled for years to come up with a simplified disclosure regime for lending products. This bill builds upon those efforts in order to create a simplified disclosure document using the Food & Drug Administration (FDA) nutrition label as a model. The intent with this measure is commendable, but it appears to be overly broad and may lead to additional confusion. The following are questions or issues that need to be addressed:

- 1) Will enhanced disclosure benefit borrowers in need of short-term lending products by demonstrating the risk associated with that product, and in turn, reduce dependency on that product?
- 2) A licensee under the CFL can engage in various types of lending activity including, unsecured personal loans, car-title loans, auto purchase lending, auto refinance and real estate loans. While the stated intent of this bill is to provide the financial facts label for unsecured consumer loans under \$2,500, the provisions of the bill apply to broad range of activity under the CFL. For example, a CFL engaged in real estate lending activity would be required to share the label, as would a CFL engaged in auto lending. Furthermore, it requires CFL licensees to post the label in various forms of advertising using a sample loan amount of \$1,000. Considering the broad range of loans that can be made or arranged under the CFL in varying amounts, this could lead to further consumer confusion as the advertisement reflects a loan amount that may not be the most common.
- 3) The sponsor contends that the requirement to issue the label only applies to loans equal to, or less than \$2,500. However, the way in which the bill is drafted requires the label to be disclosed for virtually all CFL loans. The \$2,500 threshold is only for unsecured consumer loans, but this exemption conflicts with other sections of the bill that require disclosure of the label for all CFL licensees.
- 4) The inclusion of the label does not alleviate current disclosure requirements. Currently CFL licensees must display a full and accurate schedule of charges in each licensed place of business that is subject to approval by the commissioner of DOC, as well as, provide borrowers with DOC approved disclosures and disclosures that comply with the federal Truth in Lending Act (TILA) requirements. This bill would require the inclusion of two different disclosures that could lead to greater consumer confusion.
- 5) The issue in #4 above also would exist for payday lenders. The bill requires payday lenders to use the label in disclosures to consumers before consummation of the loan and in all advertising materials. The inclusion of these requirements is in addition to current requirements that public posting of rates, as well as, consumer disclosure of rates. Will the inclusion of additional disclosures create confusion?
- 6) The disclosure would require the inclusion a caption regarding how loan payments will affect the borrower's debt budget. This required disclosure uses an average income amount for demonstration purposes, but could lead to consumer confusion. Additionally, it includes a statement that the "Percent of Monthly Debt Budget" value is calculated using a "recommended debt-to-income ratio level of 15 percent." Is it appropriate to codify this

statement in law regarding appropriate DTI standards? Would this statement imply that the Legislature, DOC or some other arm of state government recommends this threshold?

- 7) An additional issue for payday lending is that the terms of payday loans are in days not months. Requiring a disclosure concerning monthly payments, when payday loans do not have month long terms could create confusion. Additionally, payday lenders are prohibited from charging a late fee, but the label would require disclosure of a fee that doesn't exist.
- 8) In addition to establishing the required disclosure that are mandatory in the label, this bill gives DOC vague guidance to use the FDA nutritional label as a model to create the financial facts label. However, the FDA nutritional label is governed by detailed and complex federal regulations and regulatory guidance dictating the size and specific placement of the label on food products. A sample of the federal regulations on the FDA nutrition label can be found at 21 CFR 101.18, 21 CFR 101.29, 21 CFR 101.310, 21 CFR 101.411, 21 CFR 101.912, and 21 CFR 101.105. Earlier in this analysis, a sample financial facts label is illustrated. Based on the general guidance in the bill, it is not guaranteed that label envisioned will, in fact, become the label created by DOC.
- 9) Should the sponsor find a lender to partner with to agree to use the label in addition to legally required disclosures to provide greater detail on the effectiveness of the label in the broader market? Should the sponsor work with DOC on setting up a pilot program to measure the effectiveness of this label. Prior to establishing a regulatory and statutory disclosure framework, it would be helpful to have greater data on the potential impact of such a financial facts label.
- 10) The sponsor's study involving 74 participants provides an indication that this idea is worth future exploration. However, a sample of 74 consumers in a controlled environment is not the same as consumers using the label when applying for an actual loan. Committee staff recommends that this idea deserves more study and consideration prior to codifying it into statute.

REGISTERED SUPPORT / OPPOSITION:

Support

None on file.

Opposition

California Financial Service Providers' Association
California Mortgage Bankers Association (CMBA)
Community Financial Services Association

Analysis Prepared by: Mark Farouk / B. & F. / (916) 319-3081