

Date of Hearing: June 23, 2014

ASSEMBLY COMMITTEE ON BANKING AND FINANCE
Roger Dickinson, Chair
SB 896 (Correa) – As Amended: May 14, 2014

SENATE VOTE: 33-0

SUBJECT: Finance lenders: nonprofit organizations: zero-interest, low-cost loans: exemptions

SUMMARY: Exempts nonprofits that facilitate zero interest, low-cost loans under specified circumstance from the California Finance Lenders Law (CFL). Specifically, this bill:

- 1) Applies the exemption to nonprofit organizations (hereinafter referred to as exempt organizations) that facilitates one or more zero-interest, low-cost installment loans with principal amounts between \$250 and \$2,500, as follows:
 - a) The organization would have to be exempt from federal income taxes pursuant to Section 501(c)(3) of the Internal Revenue Code, and no part of the net earnings of the organization could benefit a private shareholder or individual.
 - i) The organization would have to file an application of exemption with the Commissioner of Business Oversight (commissioner) and would have to pay a fee to the commissioner in an amount calculated by the commissioner to cover costs to administer the bill.
 - ii) Once granted an exemption, an exempt organization would have to file an annual report with the commissioner, containing relevant information that the commissioner reasonably requires regarding lending facilitated by that organization and its non-profit partners within the state during the preceding calendar year.
- 2) Provides that loans made by the exempt organization would have to be unsecured, zero-interest loans, which would have to be of certain minimum duration and be underwritten as specified (see below). The exempt organization would have to provide specified disclosures to borrowers in connection with these loans, report borrower payment history to at least one consumer reporting agency that compiles and maintains files on consumers on a nationwide basis, and would be limited with respect to fees that could be charged to borrowers in connection with these loans, and prohibits loan refinance.
- 3) Specifies that the CFL does not apply to a nonprofit organization which partners with an exempt organization for the purpose of facilitating zero-interest loans, provided that all of the following conditions are met:
 - a) The partnership between the exempt organization and each partnering organization would have to be formalized through a written agreement that specifies the obligations of each of the parties, and which requires the partnering organization to comply with all of the loan-related provisions of the bill and any regulations the commissioner may promulgate to administer the bill;

- b) The partnering organization would have to be a 501(c)(3), and no part of the net earnings of the partnering organization could benefit a private shareholder or individual;
 - c) The loans facilitated by the partnering organization would have to comply with all of the loan requirements summarized above;
 - d) Each exempt organization would have to notify the commissioner within 30 days of entering into a written agreement with a partnering organization on a form prescribed by the commissioner. At a minimum, this notification would have to include the name of the partnering organization, contact information for a person responsible for the lending activities facilitated by that partnering organization, and the address or addresses at which the organization facilitates lending activities; and,
 - e) Each exempt organization would have to submit information to the commissioner regarding the loans facilitated by each of the nonprofit organizations with which it partners for the commissioner's inclusion in the report described in Number 6 below.
- 4) Authorizes the commissioner to examine each exempt organization and each partnering organization for compliance with the provisions of the bill, requires any organization examined to make available to the commissioner or his or her representative all books and records requested by the commissioner related to the lending activities facilitated by that organization, and require the cost of any such examination to be paid by the exempt organization (thus exempt organizations would pay for their examinations and for the examinations of non-profits with which they partner).
- 5) Gives the commissioner the authority to decline to grant an exemption, suspend or revoke an exemption, terminate a written agreement between a partnering organization and an exempt organization, disqualify a partnering organization from engaging in certain activities, bar a partnering organization from facilitating lending at specific locations, and/or prohibit partnerships between exempt organizations and other specific organizations, as specified, and as necessary for the protection of the public.
- 6) Requires the commissioner to annually post a report on Department of Business Oversight's (DBO) Internet web site summarizing all the following information: the number of organizations that applied for exemptions; the number of organizations granted exemptions; the number of organizations that entered into partnership with exempt organizations; the reason or reasons applications for exemption were denied, if applicable; the number of borrowers who applied for loans through exempt or partnering organizations; the number of borrowers who obtained loans facilitated by exempt or partnering organizations; the total amount loaned; the distribution of loan lengths upon origination; the number of borrowers who obtained more than one loan facilitated by an exempt or partnering organization and the distribution of the number of loans per borrower; among the borrowers who obtained more than one loan facilitated by an exempt or partnering organization, the percentage of those borrowers whose credit scores increased between successive loans and the average size of that increase; the income distribution of borrowers upon loan origination, as specified; the purposes for which loans facilitated by an exempt or partnering organization were obtained; the extent to which borrowers self-reported that they had a bank account at the time of their loan application and the extent to which these borrowers also used check-cashing services; the performance of loans, as specified; the number and types of violations of the provisions of the

bill by exempt and partnering organizations; the number of times the commissioner suspended or revoked an exemption granted to an exempt organization or sanctioned a partnering organization; the number of complaints received by the commissioner about an exempt or a partnering organization and the nature of those complaints; and recommendations, if any, for improving the program.

EXISTING LAW

- 1) Provides for the CFLL, administered by DBO, which authorizes the licensure of finance lenders, who may make secured and unsecured consumer and commercial loans (Financial Code Sections 22000 et seq.). The following are the key rules applied to consumer loans made pursuant to the CFLL:
 - a) CFLL licensees who make consumer loans under \$2,500 are capped at interest rates which range from 12% to 30% per year, depending on the unpaid balance of the loan (Sections 22303 and 22304). Administrative fees are capped at the lesser of 5% of the principal amount of the loan or \$50 (Section 22305);
 - b) In addition to the requirements in “a” above, CFLL licensees who make consumer loans under \$5,000 are prohibited from imposing compound interest or charges (Section 22309); are limited in the amount of delinquency fees they may impose (Section 22320.5; delinquency fees are capped at a maximum of \$10 on loans 10 days or more delinquent and \$15 on loans 15 days or more delinquent); are required to prominently display their schedule of charges to borrowers (Section 22325); are prohibited from splitting loans with other licensees (Section 22327); are prohibited from requiring real property collateral (Section 22330), and are limited to a maximum loan term of 60 months plus 15 days (Section 22334);
 - c) In addition to the requirements in “a” and “b” above, CFLL licensees who make consumer loans under \$10,000 are limited in their ability to conduct other business activities on the premises where they make loans (Section 22154); must require loan payments to be paid in equal, periodic installments (Section 22307); and must meet certain standards before they may sell various types of insurance to the borrower (Sections 22313 and 22314); and,
 - d) Generally speaking, the terms of loans of \$10,000 or above are not restricted under the CFLL.
- 2) Until January 1, 2018, provides for the Pilot Program for Increased Access to Responsible Small Dollar Loans within the CFLL (Financial Code Section 22365 et seq.). Significant elements of that program are summarized below.

FISCAL EFFECT: According to the Senate Appropriations Committee analysis, preliminary estimates are \$95,000 annually, potentially offset by fee revenue (Special Fund).

COMMENTS:

In support of the bill the author's office provides:

SB 896 attempts to address two related problems: 1) the lack of affordable, credit-building, small-dollar loans in California in amounts under \$2,500 and 2) the lack of legal and regulatory certainty provided under California law to nonprofit organizations

that facilitate affordable, credit-building, small-dollar loans.

The first problem is fairly well characterized. Californians who lack credit scores or have very thin credit files currently have very few affordable options when they need to borrow money; credit cards and low interest rate installment loans are commonly unavailable to them. Californians with subprime credit scores also have few options, and typically access payday lenders when their incomes fail to match their spending needs.

The lack of choices available to borrowers who cannot qualify for credit cards, bank, or credit union loans, and who require credit with which to meet their expenses is borne out by a comparison of the number of small dollar value installment loans made each year in California with the number of payday loans made each year. During 2012 (the most recent year for which lending data are available for all CFLL licensees), CFLL licensees made approximately 265,000 unsecured consumer loans with principal amounts under \$2,500. This compares with 12.3 million deferred deposit transactions (payday loans), which were made by licensed payday lenders during the same calendar year. Although the Legislature has taken steps to help close this gap (most recently through enactment of SB 318, Hill et al., Chapter 467, Statutes of 2013), there is consensus among for-profit businesses, not-for-profit organizations, and the regulatory community that more should be done to encourage affordable, credit-building, small dollar lending.

The second problem has not previously received Legislative attention. One of the not-for-profit organizations that is attempting to increase access to affordable, credit-building, small-dollar loans is the Mission Asset Fund, based in San Francisco. During the past five years, MAF has facilitated approximately 2,000 affordable, credit-building loans, totaling over \$2.1 million, in California. MAF's lending volume has increased each year since inception, reaching \$750,000 in the most recent year. MAF serves borrowers directly, through its presence in the San Francisco Bay Area, and indirectly, through partnerships with other nonprofit organizations. It currently works with nineteen different nonprofit partners across six different states, including three different groups in Los Angeles.

SB 896 would authorize a non-profit organization that meets certain criteria to apply with DBO for an exemption from the CFLL and would require a non-profit organization granted an exemption by DBO to comply with specified requirements related to the loans it facilitates. SB 896 would further provide that non-profit organizations which partner with exempt non-profits are not subject to the CFLL, if they meet specified criteria and comply with specified requirements.

The length of the loans, underwriting requirements applied to the loans, disclosures provided to borrowers, fees that could be charged to borrowers, and other rules of the program would be identical to the rules applicable to lenders accepted into the Pilot Program for Increased Access to Responsible, Small Dollar Loans, except as shown in the table below.

	Pilot Program for Increased Access to Responsible, Small Dollar Loans (SB 318, Chapter 467, Statutes of 2013)	SB 896
Entities Expected To Utilize The Bill	For-profits with socially responsible missions	Non-profits with socially responsible missions
Interest Rates (Percentage)	Capped at 36% on the first \$1,000 borrowed and 32% on principal amounts between \$1,001 and \$2,500. The 32% rate can rise to a maximum of 35% as the prime rate rises.	0%
Origination Fees	Capped at the lesser of 7% or \$90 on the first loan to a borrower; lesser of 6% or \$75 on the second and subsequent loans to a borrower	Same as SB 318
Late Fees	Capped at \$14 after 7 days or \$20 after 14 days; actual insufficient funds fee may also be charged to a borrower	An insufficient funds fee capped at \$10 may be charged in lieu of any other late fee or delinquency fee
Loan Amounts	\$300 to \$2,500	\$250 to \$2,500
Minimum Loan Lengths	90 days for loans <\$500; 120 days for loans \$500 - \$1,499; 180 days for loans \$1,500 - \$2,500	Same as SB 318
Underwriting Requirements	Income and debts must be independently verified by the lender. Monthly debt service payments, including the loan for which the borrower is being considered, may not exceed 50% of the borrower's gross monthly household income.	Same as SB 318 with one modification: If a borrower's actual income cannot be independently verified, a signed statement from the borrower regarding their monthly income may be used, but the debt-to-income cap drops from 50% to 25%.

Credit Education Offered at Loan Origination?	Yes	Yes
Borrower Payment History Reported to Credit Bureau?	Yes	Yes
Refinancing Allowed?	Yes, under certain circumstances	No
Disclosures Provided at Loan Origination	Yes; Must be in writing, type size no smaller than 12 point font: amount borrowed, total dollar cost of the loan to the consumer if the loan is paid back on time, APR, periodic payment amount, delinquency fee schedule, and a statement that “repaying your loan early will lower your borrowing costs by reducing the amount of interest you will pay. This loan has no prepayment penalty.”	Same as SB 318, except for the statement that repaying a loan early will lower borrowing costs (because SB 896 loans are zero-interest, this statement does not apply).
Payment Reminders	Required 2 days prior to each payment due date; borrower may opt out if he/she wishes	Same as SB 318
Annual Report to DBO by Entities Accepted into the Program	Yes	Yes
Annual Report by DBO on Program Performance	Yes	Yes

Chart prepared by Senate Banking Committee

AB 896 is sponsored by Mission Asset Fund (MAF), based in San Francisco that has facilitated over \$2.5 million in social loans through their Lending Circles program designed to increase wealth and assets among low income people. The MAF Lending Circles program was studied, beginning in 2011, by a team of researchers from San Francisco State University's Cesar E. Chavez Institute. The two year research study found that Lending Circle participants on average improved their credit scores 4 times greater than non-participants: 168 points vs 41 points. Participants also reduced debt and increased savings. The loans made as part of the research study were found to save the participants \$42,636 in fees and interest due to the use of zero-

interest, low cost loans. The report is available at <http://cci.sfsu.edu/files/MAF%20Replication.pdf>.

What are lending circles, and how do they work? The lending circle model around which SB 896 is written was developed by MAF, based on the time-tested model used worldwide, in multiple cultures. Lending circles are groups of ten to twelve people who are connected by a common bond, and who agree to lend money to one another and pay each other back in an organized fashion. The lending circle model has been used for many years in regions throughout the world, primarily in cultures where money is scarce and individuals are accustomed to pooling their resources to achieve their economic goals. Different cultures call these circles by different names, including tandas or cundinas (in Mexico), susus (throughout Africa), paluwagan (in the Philippines), and lun-hui (in China).

The lending circle model works as follows: each individual in the circle must agree to pay a certain amount to the group at a frequency that is agreed upon by all members of the group (thus, for example, each member of a ten-person lending circle could agree to pay \$100 to the group, once a month, generating \$1,000 per month). A lottery is used to determine the order in which members of each lending circle gain access to the payment proceeds. In the example immediately above, each of the ten members in the circle would be able to borrow \$1,000 each month – one borrower per month – until all ten members of the lending circle had paid \$1,000, and all had borrowed \$1,000.

The key difference between lending circles facilitated by MAF and the informal lending circles that have been used in other cultures for decades is the formalized manner in which MAF facilitates the lending. MAF is not the lender in its lending circles; that role is played by the members of the circle. However, MAF plays a vitally important role as facilitator of the circles. It enters the picture in four ways. First, it helps individuals who wish to form lending circles do so, by explaining the rules, underwriting the members of each circle, and providing the paperwork necessary to formalize the lending circle loan agreements. Second, MAF offers free financial education to lending circle participants. The financial management training classes offered by MAF are directly linked to credit, borrowing, and savings topics that lending circle participants experience in their circles. Third, MAF guarantees the loans. If any member of a lending circle is unable to fulfill their loan agreement by fully repaying their loan amount, MAF steps in to take up those payments, thus ensuring that the other members of the circle, who have made their payments, get fully repaid. In the alternative, MAF helps the circle identify a replacement for the member of the lending circle that dropped out, to ensure that the circle is completed and all loans are fully repaid. Finally, MAF reports borrower payment histories to at least one of the major credit bureaus. This helps individuals who participate in lending circles to establish, build, and/or repair their credit scores.

REGISTERED SUPPORT / OPPOSITION:

Support

Mission Asser Fund (Sponsor)
Asian Law Alliance
Calexico Community Action Council, Inc.
California Association for Micro Enterprise Opportunity (CAMEO)
California State Controller

Californians for Shared Prosperity Coalition
City and County of San Francisco
Corporation for Enterprise Development (CFED)
Earn
Greenlining Institute
National Council of La Raza
Opportunity Fund
Pilipino Workers Center of Southern California
Progreso Financiero
San Francisco Board of Supervisors, David Campos
San Francisco Office of Financial Empowerment
The Center for Asset Building Opportunities (CABO)
The Family Independence Initiative
Watts/Century Latino Organization

Opposition

None on file.

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