Assembly Banking and Finance Committee
2015–2016 Summary of Legislation

Matthew Dababneh, Chair
Travis Allen, Vice Chair

Members:

Katcho Achadjian
Susan Bonilla
Cheryl Brown
Ed Chau
Mike Gatto
David Hadley
Young Kim
Evan Low
Sebastian Ridley-Thomas
Mark Stone

Committee Staff:

Mark Farouk, Chief Consultant
Kathleen O'Malley, Principal Consultant
Tiffany Morrison, Committee Secretary

Business Filings

AB-871 (Brown) - Business filings: statement of information.

This bill would have changed the filing date for statements of information (SOIs) that various corporate entities file annually or biennially with the Secretary of State (SOS) as follows: Require all corporations to file by March 15th of each year rather than the calendar month in which the original articles of incorporation (AOI) were filed. Require all limited liability companies (LLCs) to file by April 15th biennially rather than the calendar month in which the original AOIs were filed. Require all nonprofit corporations to file by May 15th biennially rather than the calendar month in which to original AOIs were filed.

Status: *Died in Assembly Appropriations Committee*

Legislative History:

Asm Banking and Finance - (11 - 0)

AB-1471 (Perea) - Business entities: filings.

Makes various technical, non-substantive, and clarifying changes in the Corporations Code in preparation for the Secretary of State (SOS) automated filing system. Specifies that any statement or certificate of conversion of a converting corporation, limited partnership, domestic limited partnership, or limited liability company (LLC) shall include the name, mailing address and street address of the converted entity's agent for service of the process. Requires the managers to sign a certificate of cancelation of the articles of organization upon the completion of the winding up affairs of the LLC rather than the persons who filed the certificate of dissolution.

Status: *Chapter 189, Statutes of 2015*

Legislative History:

Assembly Floor - (78 - 0)
Assembly Floor - (78 - 0)
Asm Banking and Finance - (12 - 0)
Senate Floor - (38 - 0)
Sen Judiciary - (7 - 0)
Sen Banking and Financial Institutions - (7 - 0)

Corporations

AB-506 (Maienschein) - Limited liability companies.

Changes the California Revised Uniform Limited Liability Company Act (RULLCA). Specifies that a limited partnership is formed when the partners enter into a partnership agreement before or after the filing of a certificate of a limited partnership. Expands the definition of "person" to include a trustee of a trust including, but not limited to, a trust described under Probate Code Division 9. Amends the definition of "electronic transmission by the limited liability company." Requires a limited liability company (LLC) to indemnify the agent of a LLC to the extent that the agent has been successful on the merits in defense or settlement of any claim, issue, or matter if the agent acted in good faith and in a manner that the agent reasonably believed to be in the best interests of the LLC and its members. Limits the RULLCA to acts or transactions existing on or after January 1, 2014, or by members or managers of the LLCs existing on or before that date. Eliminates the requirement requiring the consent of all members of the LLC to approve a merger or conversion, as well as, to amend the operating agreement. Requires profits and losses of a LLC be allocated among the members, and among classes of members, in the manner provided in the operating agreement and would require that profits and losses be allocated in the proportion to the value of the contributions from each member if the operating agreement does not otherwise provide. Modifies what an operating agreement may provide. Specifies that upon dissociation, a person's right to vote as a member in the management and conduct of the LLCs activities terminates. Authorizes, if a member dies or a guardian or general conservator is appointed for the member, the member's executor, administrator, guardian, conservator, or other legal representative to exercise all of the member's rights for the purpose of settling the member's estate or administering the member's property, including any power the member had under the articles of organization or an operating agreement to give a transferee the right to become a member. Provides that specified provisions of the Labor Code, relating to consideration for employment and employment contracts, shall not apply to membership interests issued by any LLC or foreign LLC. Changes LLC "certificate of dissolution" to "certificate of cancellation."

Status: *Chapter 775, Statutes of 2015*

Legislative History:

Assembly Floor - (80 - 0)
Assembly Floor - (76 - 0)
Asm Banking and Finance - (12 - 0)
Senate Floor - (40 - 0)
Sen Judiciary - (6 - 0)

AB-557 (Irwin) - Nonprofit corporations: abatement: dissolution: surrender.
Establishes a mechanism for dissolving or surrendering nonprofit corporations if their corporate powers were suspended or forfeited by the Franchise Tax Board for a period of 48 continuous months.
Status: *Chapter 363, Statutes of 2015*
Legislative History:
Assembly Floor - (78 - 0)
Assembly Floor - (78 - 0)
Asm Appropriations - (17 - 0)
Asm Revenue and Taxation - (9 - 0)
Asm Banking and Finance - (11 - 0)
Senate Floor - (38 - 0)
Sen Governance and Finance - (6 - 0)
Sen Banking and Financial Institutions - (7 - 0)

AB-792 (Chiu) - Board of directors: investment standards.
Provides that compliance by a nonprofit public benefit or nonprofit religious corporation with the Uniform Prudent Management of Institutional Funds Act (UPMIFA), as specified, constitutes compliance with the investment standards applicable to these corporations.
Status: *Chapter 56, Statutes of 2015*
Legislative History:
Assembly Floor - (77 - 0)
Asm Banking and Finance - (12 - 0)
Senate Floor - (37 - 0)
Sen Banking and Financial Institutions - (7 - 0)

AB-816 (Bonta) - Cooperative corporations: worker cooperatives.
Authorizes and expands the consumer cooperative corporation law to allow general worker cooperatives, and establishes a regulatory framework for the formation and operation of cooperative corporations.
Status: *Chapter 192, Statutes of 2015*
Legislative History:
Assembly Floor - (59 - 18)
Assembly Floor - (55 - 17)
Asm Appropriations - (12 - 5)
Asm Banking and Finance - (9 - 3)
Senate Floor - (39 - 0)
Sen Banking and Financial Institutions - (7 - 0)

AB-844 (Bloom) - Search warrants: foreign corporations and foreign limited liability companies.
Authorizes a foreign corporation and foreign limited liability company to consent to service of process for a search warrant by email or submission to a designated Internet Web portal.
Status: *Chapter 57, Statutes of 2015*
Legislative History:
Assembly Floor - (77 - 0)
Asm Banking and Finance - (12 - 0)
Asm Public Safety - (7 - 0)
Senate Floor - (37 - 0)
Sen Public Safety - (7 - 0)

AB-1380 (O'Donnell) - Nonprofit corporations: corporation sole.

Requires the Secretary of State, if he or she determines the articles of incorporation to form a corporation sole did not conform to law, to nonetheless file it if the articles of incorporation are resubmitted with an accompanying written opinion of a member of the State Bar of California that the specific provision of the articles of incorporation objected to by the Secretary of State conform to law and state the points and authorities upon which the written opinion is based.

Status: *Died Assembly Banking and Finance Committee*

AB-1686 (Travis Allen) - Close corporations.

Increases the threshold of people that can own shares in a close corporation.

Status: *Died in Assembly Banking and Finance Committee*

AB-1722 (Wagner) - Limited liability companies: dissolution: cancellation of articles of organization.

Makes changes to California's Revised Uniform Limited Liability Company Act (RULLCA). Specifically, allows a limited liability company (LLC) to dissolve by a vote of 50 percent or more of the voting interests of the members. Allows a domestic LLC to cancel the articles of organization with 50 percent or more of the voting interests of the members or managers or 50 percent or more of the persons signing the articles of incorporation.

Status: *Chapter 66, Statutes of 2016*

Legislative History:

Assembly Floor - (76 - 0)
Asm Appropriations - (18 - 0)
Asm Banking and Finance - (12 - 0)
Senate Floor - (37 - 0)
Sen Judiciary - (7 - 0)

AB-2637 (Wilk) - Franchise investments: offer and sale of registered franchises: registration exemption.

Would have changed the California Franchise Investment Law (CFIL). Specifically, eliminates some of the conditions that must be met in order for a franchisor to claim the exemption from the franchisor having to amend its franchise registration in connection with a negotiated sale. , Deletes a requirement that the franchisor provide a copy of the negotiated terms to the prospective franchisee within five business days following the request of the franchisee.

Adds a requirement that provides the cover page, a state cover page, or a state addendum of the disclosure document to state "You and the franchisor may agree to sign the forms of franchise agreement and other agreements attached to this disclosure document. However, California law does not prohibit you and the franchisor from negotiating changes to the franchise agreement and other agreements, nor does it require you or the franchisor to negotiate any changes."

Status: *Assembly-Vetoed*

Legislative History:

Assembly Floor - (78 - 1)
Assembly Floor - (79 - 0)
Asm Appropriations - (20 - 0)
Asm Banking and Finance - (12 - 0)

Senate Floor - (39 - 0)
Sen Appropriations - (7 - 0)
Sen Appropriations - (7 - 0)
Sen Judiciary - (7 - 0)
Sen Banking and Financial Institutions - (7 - 0)

Governor's Veto Message:

Governor's veto message: To the Members of the California State Assembly:

I am returning Assembly Bill 2637 without my signature.

This bill allows franchisors to negotiate changes to a franchise agreement without disclosing the terms to the Department of Business Oversight (Department) or to other prospective franchisees.

While it is important to promote bringing new business into California, doing so at the expense of transparency could be detrimental to potential franchisees, as this bill proposes to do. The current process, which allows the Department to review contract changes, ensures that franchisees are not placed at a disadvantage in their final agreement.

Sincerely,

Edmund G. Brown Jr.

AB-2759 (Levine) - Corporations: agents: victims of corporate fraud compensation fund.

Seeks to compensate victims of corporate fraud committed by corporate officers from the Victims of Corporate Fraud Compensation Fund (VCFCF). Allows an individual who is a victim of corporate fraud and who wins a civil judgment against a corporate officer or obtains a final criminal restitution order in connection with the fraudulent acts of a corporate officer, but is unable to collect the judgment from the officer after diligent efforts to do so, to collect damages from the VCFCF in the same manner as a similarly situated victim of corporate fraud with a judgment against a corporation would be able to do.

Status: *Chapter 390, Statutes of 2016*

Legislative History:

Assembly Floor - (78 - 0)	Senate Floor - (39 - 0)
Assembly Floor - (80 - 0)	Sen Appropriations - (5 - 0)
Asm Appropriations - (20 - 0)	Sen Appropriations - (7 - 0)
Asm Banking and Finance - (11 - 0)	Sen Judiciary - (7 - 0)
Asm Judiciary - (10 - 0)	Sen Banking and Financial Institutions - (7 - 0)

SB-351 (Committee on Banking and Financial Institutions) - Corporations.

Cleans up various provisions of the Corporations Code to correct drafting errors in prior legislation and clarify the intent of existing law.

Status: *Chapter 98, Statutes of 2015*

Legislative History:

Assembly Floor - (76 - 0)	Senate Floor - (39 - 0)
Asm Banking and Finance - (12 - 0)	Senate Floor - (38 - 0)
	Sen Judiciary - (7 - 0)
	Sen Banking and Financial Institutions - (7 - 0)

Credit Reports

AB-1553 (Irwin) - Consumer credit reports: security freezes: protected person.

This bill would have authorized a representative of a protected person, defined as an individual who is under 16 years of age at the time a request for the placement of a security freeze is made or an incapacitated person or a protected individual for whom a guardian or conservator has been appointed, to place a security freeze on the credit report of the protected person by making a request in writing by mail to a consumer credit reporting agency.

Status: *Was amended out of Committee Jurisdiction.*

AB-1580 (Gatto, Irwin) - Consumer credit reports: security freezes: protected consumer.

Permits a parent or other legal representative to freeze a child's credit records with the three major consumer credit reporting agencies (CCRAs), and requires a CCRA to create a record for the protected consumer and impose a security freeze within 30 days of receiving a request if a file for that person does not already exist.

Status: *Chapter 494, Statutes of 2016*

Legislative History:

Assembly Floor - (80 - 0)
Assembly Floor - (78 - 0)
Asm Privacy and Consumer Protection - (11 - 0)
Asm Banking and Finance - (12 - 0)
Senate Floor - (38 - 0)
Sen Judiciary - (7 - 0)

AB-1581 (Rodriguez) - Consumer credit reports: security freezes: fees.

This bill would have prohibited a consumer credit reporting agency from charging any consumer for the placement of each freeze, the removal of the freeze, the temporary lift of the freeze for a period of time, or the temporary lift of the freeze for a specific party, regarding access to a consumer credit report. The bill would have also prohibited a consumer credit reporting agency from charging a fee to a victim of identity theft who has submitted a valid police report or valid Department of Motor Vehicles investigative report that alleges a violation of Section 530.5 of the Penal Code.

Status: *Died in the Assembly Banking and Finance Committee.*

Debt Collection

AB-1723 (Dodd) - Debt collection.

Requires a debt collector that has reported adverse information about a debtor to a consumer credit reporting agency (CCRA), upon receipt of a police report and written statement by a debtor in which the debtor claims to be a victim of identity theft, to notify the CCRA that the account is disputed and initiate a review within 10 business days. Provides that a debt collector shall send notice of its determination to the debtor no later than 10 business days after concluding the review. Specifies that if the debt collector has furnished adverse information to a CCRA the debt collector shall notify the CCRA to delete the information no later than 10 business days after making its determination. Provides that a creditor shall not pursue further collections, or sell a consumer debt once debt collection activities have been terminated based upon the debtor's claim of identity theft.

Status: *Chapter 376, Statutes of 2016*

Legislative History:

Assembly Floor - (79 - 0)
Assembly Floor - (77 - 0)
Asm Judiciary - (10 - 0)
Asm Banking and Finance - (12 - 0)
Senate Floor - (38 - 0)
Sen Judiciary - (7 - 0)

AB-2420 (Jones) - Debt collection: attorneys: exemption.
Exempts from the definition of a "debt collector" a law firm.
Status: *Died in the Assembly Banking and Finance Committee.*

SB-641 (Wieckowski) - Debt buying: default judgment.
Adds a provision to the Fair Debt Buying Practices Act (FDBPA) to provide consumers, in limited circumstances involving actions brought by debt buyers, extended time to file a motion to set aside a default or default judgment and for leave to defend an action relating to debt, if the service of summons did not result in actual notice to the consumer in time to defend the action. This bill requires, except in cases of identity theft or mistaken identity, that the consumer serve and file the notice of motion within a reasonable time, but in no event exceeding the earlier of either: (1) six years after entry of the default or default judgment; or (2) 180 days of the first actual notice of the action, as specified.
Status: *Chapter 804, Statutes of 2015*
Legislative History:
Assembly Floor - (45 - 26)
Asm Appropriations - (11 - 5)
Asm Judiciary - (7 - 3)
Asm Banking and Finance - (7 - 2)
Senate Floor - (28 - 11)
Senate Floor - (29 - 10)
Sen Judiciary - (5 - 2)

Escrow

AB-2416 (Wilk) - Escrow agent rating service.
Deletes the sunset date of January 1, 2017 of the statute governing escrow agent rating services thereby extending the statute indefinitely.
Status: *Chapter 135, Statutes of 2016*
Legislative History:
Assembly Floor - (76 - 0)
Assembly Floor - (76 - 0)
Asm Banking and Finance - (12 - 0)
Senate Floor - (37 - 0)
Sen Judiciary - (7 - 0)

SB-736 (Vidak, Block) - Escrow agents.
Requires that, whenever possible, the Commissioner of the Department of Business Oversight (DBO) use the services of private individuals with prior escrow experience to act as conservator, receiver, or liquidator for instances in which the commissioner must take possession of the assets and business of an escrow agent following that agent's insolvency. The bill authorizes the commissioner to use all or a portion of the insolvent escrow agent's surety bond and assets following conversion, as well as redirect up to $125,000 in penalty revenue at any one time, to compensate private conservators, liquidators, and receivers.
Status: *Died in Assembly Appropriations*
Legislative History:
Asm Banking and Finance - (11 - 0)
Senate Floor - (40 - 0)
Sen Appropriations - (7 - 0)
Sen Appropriations - (7 - 0)
Sen Banking and Financial Institutions - (6 - 0)

Finance Lenders

AB-268 (Dababneh) - California Finance Lenders Law: unsecured loans: terms and conditions: violations

Revised and imposed additional terms and conditions under which a licensee may make unsecured consumer loans of a maximum principal balance upon origination of $3,000 or less, including, among other things, the term of the loan, maximum rates that a licensee may charge for a loan, and restrictions on refinancing, as specified. The bill would allow a licensee, with prior approval from the commissioner, to use the services of one or more referral partners with respect to those loans that the licensee may make or negotiate, if specified conditions and requirements are met.

Status: *Died in Senate Banking and Financial Institutions.*

Legislative History:

Assembly Floor - (76 - 0)
Asm Appropriations - (13 - 0)
Asm Banking and Finance - (10 - 0)

AB-1446 (Dababneh) - California Finance Lenders Law: violations.

Clarifies the authority of the commissioner of the Department of Business Oversight (DBO) to issue desist and refrain orders against licensees under the California Finance Lenders Law (CFLL). This bill specifies that the commissioner may order a person engaged as a broker, finance lender, or mortgage loan originator to desist and refrain from violations of a provision of an order or any regulation adopted under the CFLL.

Status: *Chapter 310, Statutes of 2015*

Legislative History:

Assembly Floor - (79 - 0)
Assembly Floor - (78 - 0)
Asm Appropriations - (17 - 0)
Asm Banking and Finance - (12 - 0)
Senate Floor - (40 - 0)
Sen Banking and Financial Institutions - (7 - 0)

SB-197 (Block) - Finance lenders: commercial loan: referral.

Authorizes California Finance Lenders Law (CFLL) licensees making commercial loans to compensate unlicensed persons for borrower referrals, as specified.

Status: *Chapter 761, Statutes of 2015*

Legislative History:

Assembly Floor - (78 - 0)
Asm Banking and Finance - (10 - 0)
Asm Appropriations - (16 - 0)
Asm Banking and Finance - (12 - 0)
Senate Floor - (39 - 0)
Senate Floor - (36 - 0)
Sen Banking and Financial Institutions - (6 - 0)

SB-235 (Block) - Small dollar loans: finder duties and compensation.

Authorizes finders under the Pilot Program for Increased Access to Responsible Small Dollar Loans (pilot program) to disburse loan proceeds to borrowers, receive loan payments from borrowers, and provide notices and disclosures to borrowers, as specified; increases allowable finder compensation; and provides pilot program lenders greater flexibility in the way(s) in which they compensate their finders.

Status: *Chapter 505, Statutes of 2015*

Legislative History:

Assembly Floor - (78 - 0)
Asm Appropriations - (17 - 0)
Asm Judiciary - (10 - 0)
Asm Banking and Finance - (11 - 0)
Senate Floor - (40 - 0)
Senate Floor - (39 - 0)
Sen Judiciary - (6 - 0)
Sen Banking and Financial Institutions - (7 - 0)

SB-657 (Berryhill, Pan) - The California Residential Mortgage Lending Act: lenders: licensees.

Revises the definition of "lender" under the California Residential Mortgage Lending Act (CRMLA) to clarify the inclusion of loan processors and underwriters under specified circumstances. Provides that a "lender" under the CRMLA is a person that is either of the following: a) Not a natural person and engages in the activities of a loan processor or underwriter for a residential mortgage loan; or, b) A natural person and an independent contractor who engages in the activities of a loan processor or underwriter for a residential mortgage loan. Allows the Commissioner of the Department of Business Oversight (DBO), at his or her discretion, to require a lender that engages in the activities of a loan processor or underwriter to maintain a minimum tangible net worth of an amount that is greater than two hundred fifty thousand dollars ($250,000), but does not exceed the net worth required by an approved lender under the Federal Housing Administration (FHA).

Status: *Chapter 797, Statutes of 2016*

Legislative History:

Assembly Floor - (78 - 0)
Asm Appropriations - (20 - 0)
Asm Banking and Finance - (12 - 0)
Senate Floor - (39 - 0)
Sen Banking and Financial Institutions - (7 - 0)
Senate Floor - (38 - 0)
Sen Appropriations - (7 - 0)
Sen Appropriations - (7 - 0)
Sen Energy, Utilities and Communications - (10 - 0)

SB-777 (Lara) - The California Finance Lenders Law: application.

Exempts from the California Finance Lenders Law (CFLL) any person who makes one commercial loan in a 12-month period.

Status: *Chapter 478, Statutes of 2016*

Legislative History:

Assembly Floor - (78 - 0)
Asm Banking and Finance - (11 - 0)
Asm Governmental Organization - (18 - 0)
Senate Floor - (39 - 0)
Sen Banking and Financial Institutions - (7 - 0)
Senate Floor - (36 - 0)
Sen Governmental Organization - (9 - 0)

SB-984 (Hueso) - Pilot Program for Increased Access to Responsible Small Dollar Loans: extension.

Extends the Pilot Program for Increased Access to Responsible Small Dollar Loans (Pilot) until January 1, 2023. Eliminates a requirement, due to poor response rate, that the Department of Business Oversight (DBO) conduct a survey of consumers who utilize the Pilot. Requires DBO to post a on their Internet Web site a report, annually on or before July 1, 2017 to July 1, 2021, inclusive summarizing utilization of the Pilot.

Status: *Chapter 480, Statutes of 2016*

Legislative History:

Assembly Floor - (77 - 0)
Asm Appropriations - (20 - 0)
Asm Banking and Finance - (12 - 0)

Senate Floor - (39 - 0)
Senate Floor - (39 - 0)
Sen Appropriations - (7 - 0)
Sen Appropriations - (7 - 0)
Sen Judiciary - (7 - 0)
Sen Banking and Financial Institutions - (6 - 1)

SB-1371 (Galgiani) - Credit disability insurance: premium payments.

Would have allowed a finance lender to offer credit disability insurance on a monthly, annual or single premium basis. Author did not move the bill forward.

Status: *Died in Banking and Finance Committee*

Legislative History:

Senate Floor - (39 - 0)
Sen Banking and Financial Institutions - (7 - 0)

Financial Institutions

AB-183 (Waldron) - Financial institutions: preauthorized electronic fund transfers.

Required a financial institution subject to oversight by the Department of Business Oversight to ensure it complies with a specific federal regulation with regard to electronic fund transfers. It would require a financial institution to provide a specified written notice to a consumer, who approved a preauthorized electronic fund transfer to a merchant from the consumer’s account, and would further require a merchant located in the state that accepts preauthorized electronic fund transfers to post the same notice on its Internet Web site, if any.

Status: *Died in Assembly Banking and Finance Committee*

AB-1933 (Travis Allen) - Banking.

Required a financial institution to post in a prominent location its banking classification as specified in its articles of incorporation.

Status: *Died in Assembly Banking and Finance Committee*

AB-2274 (Dababneh) - Credit unions.

Changes the California Credit Union Law. Requires the credit union's board of directors to meet on a regular basis, not less than quarterly, as determined by the board. Removes a requirement for the directors to, at least quarterly, review a report of membership applications approved by an officer, director, committee member, or employee to whom the directors delegated the authority to approve applications for new membership. Requires the membership of the supervisory committee to be an odd number and would authorize, in lieu of the requirement for a supervisory committee, the establishment of an audit committee and the selection of the members of the audit committee. Deletes a provision requiring any application for any loan or extension or guarantee of credit, to state in writing the purpose for which the loan or extension or guarantee of credit is desired and, if applicable, describe the property that is proposed to secure the loan or extension or guarantee of credit. Permits nonmember to participate in an obligation or extension of credit to a member as a co-borrower, surety, or guarantor. Modifies the definition of "official" to include member of the audit committee, credit manager, president, or chief executive officer of a credit union and to remove the position of an officer. Removes a provision that would prohibit an obligation with a member that is not a natural person and results in liability to the credit union in excess of that member's investment in the credit union unless an exception is authorized in the credit union's bylaws and approved by the commissioner.

Status: *Chapter 353, Statutes of 2016*

Legislative History:

Assembly Floor - (78 - 0)
Assembly Floor - (79 - 0)
Asm Appropriations - (20 - 0)
Asm Banking and Finance - (12 - 0)
Senate Floor - (38 - 0)
Sen Banking and Financial Institutions - (7 - 0)

AB-2907 (Committee on Banking and Finance) - State government: omnibus technical changes.

Makes technical and non-substantive changes to provisions of the Financial Code.

Status: *Chapter 277, Statutes of 2016*

Legislative History:

Assembly Floor - (79 - 0)
Assembly Floor - (76 - 0)
Asm Banking and Finance - (12 - 0)
Senate Floor - (37 - 0)
Sen Banking and Financial Institutions - (7 - 0)

AJR-25 (Lackey) - Access to financial institutions.

This resolution memorializes the President and Congress to support legislation that will provide a comprehensive solution to allow banks and credit unions to perform financial services for marijuana businesses.

Status: *Chapter 202, Statutes of 2015*

Legislative History:

Assembly Floor - (67 - 3)
Asm Banking and Finance - (9 - 1)
Senate Floor - (36 - 3)

Financial Literacy

AB-1292 (Dababneh) - Bank on California program.
Establishes the Bank on California Program within the Department of Business Oversight (DBO) and requires DBO to report annually to the chairpersons of the Senate Committee on Banking and Financial Institutions and Assembly Committee on Banking and Finance regarding the activities of the Bank On California Program.
Status: *Chapter 750, Statutes of 2015*
Legislative History:

Assembly Floor - (77 - 0)	Senate Floor - (40 - 0)
Asm Appropriations - (17 - 0)	Sen Appropriations - (7 - 0)
Asm Banking and Finance - (11 - 0)	Sen Appropriations - (7 - 0)
	Sen Banking and Financial Institutions - (7 - 0)

AB-1784 (Dababneh) - State banks.
Allows state chartered banks to participate in school-based financial education programs (Programs). Permits the Programs to receive deposits or pay withdrawals on the premises of, or at a facility used by, a school. Specifies that the school premises or facility will not be considered a branch office if: a) The bank does not establish and operate the school premises or facility in which the program is conducted; b) Bank employees work at the site only to participate in the Program; c) The Program is provided at the discretion of the school; d) The principal purpose of the Program is financial education; e) No services are provided to the general public; and, f) The program is conducted in a manner that is consistent with safe and sound banking practices and complies with applicable law. Provides that a state chartered bank that participates in a program shall be liable for all deposits made on the premises of, or at a facility used by, a school as if the deposit was made directly at a branch office of the bank.
Status: *Chapter 180, Statutes of 2016*
Legislative History:

Assembly Floor - (77 - 0)	Senate Floor - (37 - 0)
Assembly Floor - (76 - 0)	Sen Banking and Financial Institutions - (7 - 0)
Asm Appropriations - (18 - 0)	
Asm Banking and Finance - (12 - 0)	

AB-2546 (Calderon) - California Financial Literacy Fund.
This bill would have declared the intent of the Legislature to enact legislation to ensure the California Financial Literacy Fund is utilized for the continuing financial education of college students and the public.
Status: *Amended and withdrawn from Assembly Banking and Finance Committee.*

Local Agency Funds and Investments

AB-2638 (Gatto) - Local Investment Advisory Board: members.
Would have extended the term of each appointed member of the Local Investment Advisory Board (LIAB) from two to three years.
Status: *Died in Governmental Organization Committee*
Legislative History:
Assembly Floor - (67 - 0)
Asm Appropriations - (20 - 0)
Asm Banking and Finance - (11 - 0)
Asm Rules - (11 - 0)

Medical Cannibas

AB-1549 (Wood) - California Cannabis Credit Union.
Would have established the California Cannabis Credit Union within the State Board of Equalization and require the board to promulgate regulations necessary for its implementation.
Status: *Chapter 505, Statutes of 2016*
Legislative History:
Assembly Floor - (80 - 0)
Assembly Floor - (78 - 0)
Asm Appropriations - (17 - 0)
Asm Transportation - (16 - 0)
Asm Rules - (11 - 0)
Senate Floor - (39 - 0)
Senate Floor - (39 - 0)
Sen Appropriations - (7 - 0)
Sen Appropriations - (7 - 0)
Sen Transportation and Housing - (10 - 0)

AB-1575 (Bonta, Cooley, Jones-Sawyer, Lackey, Wood) - Medical cannabis.
Made changes to the Medical Marijuana Regulation and Safety Act (MMRSA). Specifically, this bill: Renames MMRSA to the Medical Cannabis Regulation and Safety Act (Act). Requires the State Board of Equalization (BOE) to form an advisory group made up of representatives from financial institutions, the medical cannabis industry, law enforcement, and state and federal banking regulators. Mandates the BOE to submit a report to the Legislature by July 1, 2017 with proposed changes to state law or regulations that will improve financial monitoring of medical cannabis and improve compliance with federal law. Requires The Department of Business Oversight (DBO) to create an enhanced financial monitoring certification for entities licensed pursuant to the Act that further enables those entities to comply with the federal banking regulations under the federal Bank Secrecy Act (BSA). Further requires DBO to consider including requirements to use electronic financial monitoring that enables real-time sales inventory tracking and other tools that allow a bank or credit union to readily access information they are required to monitor under the federal BSA. Allows DBO to collect fees from applicants requesting the enhanced financial monitoring certification in an amount sufficient to fund the actual reasonable costs of

implementation. Specifies that a financial institution that provides financial services to a licensee under the Act is exempt from any criminal law of this state, provided that the financial institution has verified the licensee has a valid license in good standing. Makes numerous other changes to MMRSA.

Status: *Died in Senate Appropriations*

Legislative History:

Assembly Floor - (65 - 8)
Asm Appropriations - (15 - 1)
Asm Banking and Finance - (8 - 2)
Asm Business and Professions - (14 - 0)
Sen Appropriations - (7 - 0)
Sen Governance and Finance - (6 - 1)
Sen Business, Professions and Economic Development - (6 - 1)

AB-2149 (Bonilla) - State Board of Equalization: state agencies: collection of cash payments: medical marijuana-related businesses.

Authorized the State Board of Equalization (BOE) to collect cash payments from medical marijuana-related businesses for other state agencies.

Status: *Amended and withdrawn from Assembly Banking and Finance Committee*

Miscellaneous

AB-283 (Dababneh) - Financial affairs.

Extends the sunset date on the authority granted to local agencies to use a private sector deposit placement service to invest up to 30% of surplus funds into deposits other than certificates of deposits, and removes the cap on funds that may be invested in any single private sector deposit placement service.

Status: *Chapter 181, Statutes of 2015*

Legislative History:

Assembly Floor - (79 - 0)
Assembly Floor - (80 - 0)
Asm Banking and Finance - (11 - 0)
Asm Local Government - (9 - 0)
Senate Floor - (39 - 0)
Sen Governance and Finance - (7 - 0)
Sen Banking and Financial Institutions - (7 - 0)

AB-1113 (Chau) - Check Sellers, Bill Payers and Proraters Law.

Specifies 30 days as the amount of time in which a person wishing to contest a desist and refrain order issued under the Check Sellers, Bill Payers and Proraters Law has in which to request a hearing on the order from the Commissioner of Business Oversight (commissioner), and 15 days as the amount of time in which the commissioner has in which to hold that hearing, as specified.

Status: *Chapter 110, Statutes of 2015*

Legislative History:

Assembly Floor - (78 - 0)
Asm Appropriations - (17 - 0)
Asm Banking and Finance - (12 - 0)
Senate Floor - (38 - 0)
Sen Banking and Financial Institutions - (7 - 0)

AB-1326 (Dababneh) - Virtual currency.
Established a framework for the licensing and regulation of virtual currency businesses by the Department of Business Oversight (DBO), effective July 1, 2016.
Status: *Died in Senate Banking and Financial Institutions Committee*
Legislative History:

Assembly Floor - (55 - 22)	Sen Appropriations - (6 - 1)
Asm Appropriations - (12 - 5)	Sen Appropriations - (7 - 0)
Asm Banking and Finance - (8 - 2)	Sen Banking and Financial Institutions - (7 - 0)

AB-1341 (Brown) - Department of Business Oversight: financial service providers: costs of licensing and regulations.
Required a licensee under the supervision of the department to pay to the commissioner its pro rata share of all costs and expenses in an amount sufficient, in the commissioner's judgment, to meet the expenses of the department in administering the applicable licensing law for the next year that includes, but shall not be limited to, the cost of routine examinations and the provision of a reasonable reserve for contingencies, with a consideration of any deficit or less any surplus actually incurred in the prior fiscal year, as specified.
Status: *Died in Assembly Banking and Finance Committee*

AB-1517 (Committee on Banking and Finance) - Business.
Makes changes intended to improve the ability of the Department of Business Oversight (DBO) to administer the laws under its jurisdiction.
Status: *Chapter 190, Statutes of 2015*
Legislative History:

Assembly Floor - (79 - 0)	Senate Floor - (40 - 0)
Assembly Floor - (78 - 0)	Sen Banking and Financial Institutions - (7 - 0)
Asm Appropriations - (17 - 0)	
Asm Banking and Finance - (12 - 0)	

AB-2251 (Mark Stone) - Student loan servicers: licensing and regulation: Student Loan Borrower's Bill of Rights.
Establishes the Student Loan Servicing Act and requires servicers of student loans to get a license from the Department of Business Oversight (DBO). Provides that it is the intent of the Legislature to promote all of the following: a) Meaningful access to federal affordable repayment and loan forgiveness benefits. b) Reliable information about student educational loans and loan repayment options. c) Quality customer service and fair treatment. Specifies that a person shall not act as a student loan servicer, directly or indirectly, without a license from the Commissioner of DBO (Commissioner). Requires a licensee shall do all of the following: a) Develop policies and procedures reasonably intended to promote compliance with this division. b) File with the Commissioner any report required by regulation or order of the Commissioner; c) Comply with the provisions of this chapter, and with any regulation or order of the Commissioner; d) Submit to periodic examination by the Commissioner as required by this chapter; e) Advise the Commissioner by amendment to its application of any material judgment filed against, or bankruptcy petition filed by, the licensee within five

days of the filing; f) Comply with any other requirement established by regulation or order of the Commissioner. g) Provide, free of charge on its Internet Web site, information or links to information regarding repayment and loan forgiveness options that may be available to borrowers and provide this information to borrowers via written correspondence or email at least once per calendar year. h) Notify the borrower concerning the sale or assignment of their loan to another entity. i) Respond to qualified written request. Provides that a licensee does not have to provide a qualified written request if the following apply: a) A qualified written request is substantially the same as a qualified written request previously made by the borrower, for which the licensee has previously complied with its obligation to respond, unless the borrower provides new and material information to support the more recent qualified written request. New and material information means information that was not reviewed by the licensee in connection with a prior qualified written request submitted by the same borrower and that is reasonably likely to change the licensee's prior response related to that request. b) A qualified written request is overbroad. A qualified written request is overbroad if the licensee cannot reasonably determine from the qualified written request the specific error that the borrower asserts has occurred on his or her account or the specific information the borrower is requesting related to his or her account. c) A qualified written request is delivered to the licensee more than one year after the licensee sells, assigns, or transfers the servicing of the student loan that is the subject of the qualified written request to another servicer. d) If a licensee determines that it is not required to comply with the requirement to respond, the licensee shall notify the borrower of the determination, and the basis for its determination, in writing not later than five business days after making such determination.

Status: *Chapter 824, Statutes of 2016*

Legislative History:

Assembly Floor - (53 - 24)
Assembly Floor - (56 - 24)
Asm Appropriations - (15 - 5)
Asm Banking and Finance - (9 - 2)
Senate Floor - (26 - 12)
Sen Banking and Financial Institutions - (5 - 2)
Sen Appropriations - (5 - 2)
Sen Appropriations - (7 - 0)
Sen Banking and Financial Institutions - (5 - 2)

AB-2275 (Dababneh) - Consumer Loans

Updated the contact information for the United States Department of Housing and Community Development. By changing the content of the information required to be included in that disclosure, the willful violation of which would be a crime under those aforementioned provisions, the bill would impose a state-mandated local program. The California Constitution requires the state to reimburse local agencies and school districts for certain costs mandated by the state. Statutory provisions establish procedures for making that reimbursement. This bill would provide that no reimbursement is required by this act for a specified reason. This bill was significantly amended and referred to Education committee.

Status: *Died in Assembly Education Committee*

Legislative History:

Asm Rules - (8 - 0)

AB-2281 (Calderon) - Housing assistance.

This bill would have required the Department of Business Oversight, in coordination with the Bureau of Real Estate, on or before January 1, 2018, to develop and implement a program providing nonmonetary incentives to sellers of single-family dwellings to sell to buyers who will occupy them, with the goal of making home buyers with preapproved loans as appealing as cash buyers. The bill would also require the department, on or before January 1, 2018, in coordination with the Bureau of Real Estate and the California Housing Finance Agency and contingent upon appropriation by the Legislature, to establish the Families Compete Program, which would provide low- to moderate-income families down payment assistance to enable them to compete in the real estate marketplace.

Status: *Died in Assembly Housing and Community Development Committee*

Legislative History:

Asm Rules - (11 - 0)

AB-2282 (Calderon) - Rental housing: large-scale buy-to-rent investors: data collection.

Restricted the activities, and requires registration of large-scale buy-to-rent investors, as defined. Requires the Department of Business Oversight (DBO) in conjunction with assistance that may be offered by county recorders to design and implement a registration program for the purpose of registering and monitoring large-scale buy-to-rent investors. Prohibits a large-scale buy-to-rent investor from placing a bid on a normal sale of a single-family home for a period of not less than 90 days. Requires DBO to consider methods to require buy-to-rent investors to renew registration of their rental property on an annual basis, including new and current single-family home rentals that they own or in which they have invested. Mandates that DBO, on or before January 1, 2018 submit to the Governor and the Legislature a report. ***Status:*** *Died on Senate Floor*

Legislative History:

Assembly Floor - (52 - 24)
Asm Appropriations - (14 - 6)
Asm Banking and Finance - (7 - 4)
Asm Housing and Community Development (4-2)
Sen Appropriations - (5 - 2)
Sen Appropriations - (7 - 0)
Sen Business, Professions and Economic Development - (6 - 1)

AB-2693 (Dababneh) - Contractual assessments: financing requirements: property improvements.

Creates the PACE Preservation and Consumer Protections Act by adding consumer protections to California's Property Assessed Clean Energy (PACE) Program. Specifically, this bill: Prohibits a local agency from permitting the owner of a residential property with four or fewer units from participating in a voluntary contractual assessment program if the owner's parcel or property does not comply with specified statutory requirements. Prohibits a local agency from permitting the owner of a residential property with four or fewer units from participating in a voluntary contractual assessment program unless both of the following apply: a) The property owner has been provided with a completed financing estimate document or a substantially equivalent document that displays the same information in a substantially similar format. b) The property owner is given the right to cancel the contractual assessment on or before midnight on the third business day.

Status: *Chapter 618, Statutes of 2016*

Legislative History:

Assembly Floor - (80 - 0)
Assembly Floor - (75 - 0)
Asm Local Government - (9 - 0)
Asm Banking and Finance - (11 - 1)
Senate Floor - (39 - 0)
Sen Judiciary - (7 - 0)
Sen Governance and Finance - (6 - 0)

SB-1475 (Committee on Governmental Organization) - State warrants: records.

Provides that only the State Controller's Office (SCO) shall keep a record of all canceled warrants instead of the SCO and the State Treasurer's Office (STO).

Status: *Chapter 158, Statutes of 2016*

Legislative History:

Assembly Floor - (77 - 0)
Asm Appropriations - (18 - 0)
Asm Banking and Finance - (11 - 0)
Senate Floor - (36 - 0)
Sen Governmental Organization - (12 - 0)

Mortgages

AB-244 (Eggman) - Mortgages and deeds of trust: successors in interest.
Would have included a successor in interest in the definition of a "borrower" under the Homeowner Bill of Rights (HBOR). Specifically, this bill defines "Successor in interest" as a natural person who provides the mortgage servicer with notification of the death of the mortgagor or trustor and reasonable documentation showing that the person is one of the following: a) The personal representative as defined in the Probate Code, of the mortgagor's or trustor's estate, b) The surviving joint tenant of the mortgagor or trustor, c) The surviving spouse of the mortgagor or trustor if the real property that secures that mortgage or deed of trust was held as community property with right of survivorship pursuant to Section 682.1 of the Civil Code; or, d) The trustee of the trust that owns the real property that secures the mortgage or deed of trust of the beneficiary of that trust. Defines "notification of the death of the mortgagor or trustor" as the provision to the mortgage servicer of a death certificate of, if a death certificate is not available, of other written evidence of death deemed sufficient by the mortgage servicer. Defines "reasonable documentation" as copies of the following documents, as may be applicable, or if the relevant documentation is not available, other written evidence of the person's status as successor in interest to the real property that secures the mortgage or deed of trust deemed sufficient by the mortgage servicer: a) In the case of a personal representative, letters testamentary, letters of administration, letters of administration with the will annexed, or letters of special administration; b) In the case of a surviving joint tenant, an affidavit of death or the joint tenant or a grant deed showing joint tenancy; c) In the case of a surviving spouse where the real property was held as community property with right of survivorship, an affidavit of death of the spouse or a deed showing community property with right of survivorship; or, d) In the case of a trustee of a trust, relevant trust documents related to the beneficiary's interest.
Status: *Died in Assembly Banking and Finance Committee*

SB-1150 (Leno, Galgiani) - Mortgages and deeds of trust: mortgage servicers and lenders: successors in interest.
Requires mortgage servicers and lenders to provide successors in interest with key information about outstanding mortgages previously held by a deceased borrower; requires servicers and lenders to allow successors in interest to assume those mortgages, as specified, and to apply and be considered for foreclosure prevention alternatives in connection with those mortgages, as specified; and provides judicial enforcement mechanisms for use by successors in interest to compel lenders and servicers to comply with the bill's provisions.
Status: *Chapter 838, Statutes of 2016*

Legislative History:

Assembly Floor - (49 - 26)
Assembly Floor - (73 - 0)
Asm Judiciary - (7 - 3)
Asm Banking and Finance - (8 - 2)

Senate Floor - (22 - 13)
Senate Floor - (21 - 14)
Senate Floor - (37 - 0)
Senate Floor - (18 - 18)
Sen Judiciary - (4 - 1)
Sen Banking and Financial Institutions - (4 - 3)

Pawnbrokers

SB-285 (Block) - Pawnbrokers: compensation: loans.
Increases the maximum rates and fees that may be charged by California pawnbrokers and allows pawnbrokers to substitute electronic notices for mailed notices, as specified.
Status: *Chapter 245, Statutes of 2015*
Legislative History:

Assembly Floor - (79 - 0)
Asm Appropriations - (14 - 0)
Asm Banking and Finance - (12 - 0)

Senate Floor - (38 - 0)
Senate Floor - (39 - 0)
Sen Judiciary - (6 - 0)
Sen Banking and Financial Institutions - (7 - 0)

SB-300 (Mendoza) - Pawnbrokers: regulations.
Authorizes pawnbrokers to extend replacement pawn loans electronically, clarifies that replacement pawn loans may also be taken out via mail or via personal representative of the borrower, clarifies the effective start dates of replacement pawn loans, and allows pawnbrokers to substitute electronic notices for mailed notices, as specified.
Status: *Chapter 417, Statutes of 2015*
Legislative History:

Assembly Floor - (78 - 0)
Asm Appropriations - (16 - 0)
Asm Privacy and Consumer Protection - (11 - 0)
Asm Banking and Finance - (12 - 0)

Senate Floor - (40 - 0)
Senate Floor - (39 - 0)
Sen Judiciary - (7 - 0)
Sen Banking and Financial Institutions - (7 - 0)

Project Finance

AB-1230 (Gomez) - California Americans with Disabilities Act Small Business Compliance Financing Act.
Establishes the California Americans with Disabilities Act Small Business Capital Access Loan Program (Program) to provide loans to small businesses so they can comply with the requirements of the Americans with Disabilities Act (ADA).
Status: *Chapter 787, Statutes of 2015*
Legislative History:

Assembly Floor - (79 - 0)
Assembly Floor - (77 - 1)
Asm Appropriations - (17 - 0)
Asm Banking and Finance - (11 - 1)
Asm Rules - (11 - 0)

Senate Floor - (39 - 0)
Sen Appropriations - (7 - 0)
Sen Appropriations - (7 - 0)
Sen Business, Professions and Economic Development - (9 - 0)

Securities

AB-667 (Wagner) - Broker-dealers: exemptions: finders.

Creates a regulatory framework for securities "finders" under the Corporate Securities Law, separate from the regulation of securities brokers and dealers.

Status: *Chapter 743, Statutes of 2015*

Legislative History:

Assembly Floor - (78 - 0)
Assembly Floor - (76 - 0)
Asm Appropriations - (17 - 0)
Asm Banking and Finance - (11 - 1)

Senate Floor - (39 - 0)
Sen Appropriations - (7 - 0)
Sen Appropriations - (7 - 0)
Sen Banking and Financial Institutions - (7 - 0)

AB-722 (Perea) - Securities transactions: qualifications by permit: liability.

This bill would have authorized a new form of securities offering in California to facilitate crowdfunding as an alternative to a similar authorization in federal law under the JOBS Act.

Status: *Died in Assembly Appropriations Committee*

Legislative History:

Asm Judiciary - (10 - 0)
Asm Banking and Finance - (9 - 2)

AB-2178 (Chiu) - Securities transactions: qualifications by permit: liability.

This bill would have authorized a new form of securities offering in California to facilitate equity crowdfunding and sets up a framework for regulating these offerings.

Status: *Died in Assembly Appropriations Committee*

Legislative History:

Asm Judiciary - (10 - 0)
Asm Banking and Finance - (11 - 1)

AB-2610 (Holden) - Securities: qualification: period of effectiveness.

This bill would have increased the effective period for a qualification eligible for a Small Corporate Offering Registration, as specified, from 12 months to 36 months, unless an issuer makes a change to its board members, directors, officers, partners, members, or trustees, in which case the qualification would become ineffective. The bill would reinstate effectiveness for the remainder of the 36-months qualification period if the offering is requalified, as specified.

Status: Died in Assembly Banking Committee

AB-2751 (Brown) - Securities: qualification: exemptions

This bill would have authorized two securities permitting exemptions under California's Corporate Securities Law of 1968 which included exempting certain agricultural entities from securities permitting requirements if certain conditions are met, and exempting certain renewable energy projects from securities permitting requirements if certain conditions are met.

Status: *Died in Assembly Appropriations Committee*

Legislative History:

Asm Banking and Finance - (11 - 0)

SB-647 (Morrell) - Real estate investments: securities: qualification exemption.
Modifies provisions of the Real Estate Law that govern the activities of threshold brokers, as defined, and deletes a requirement that certain persons engaged in the offer or sale of real estate securities submit information regarding their activities to the Department of Business Oversight (DBO).
Status: *Chapter 263, Statutes of 2015*
Legislative History:

Assembly Floor - (79 - 0)
Asm Appropriations - (16 - 0)
Asm Banking and Finance - (12 - 0)
Senate Floor - (40 - 0)
Senate Floor - (36 - 0)
Sen Judiciary - (6 - 0)
Sen Banking and Financial Institutions - (7 - 0)

SB-726 (Hueso) - Corporate securities: unlawful conduct.
This bill would have required the Commissioner of the Department of Business Oversight (DBO) to adopt regulations that prohibit fraudulent and manipulative practices by persons undertaking short sales in the securities market.
Status: *Died in Assembly Appropriations Committee*
Legislative History:

Asm Banking and Finance - (9 - 1)
Asm Rules - (10 - 0)
Senate Floor - (35 - 0)
Sen Energy, Utilities and Communications - (11 - 0)

State Finance

AB-1195 (Ridley-Thomas) - California Debt Limit Allocation Committee: American Recovery and Reinvestment Act of 2009.
Allows the California Debt Limit Allocation Commission (CDLAC) to allocate private activity bond ceiling to applicants seeking to issue qualified public education facility bonds.
Status: *Chapter 277, Statutes of 2015*
Legislative History:

Assembly Floor - (77 - 0)
Asm Banking and Finance - (12 - 0)
Senate Floor - (38 - 0)
Sen Education - (9 - 0)
Sen Governance and Finance - (7 - 0)

AB-1393 (Burke) - California Pollution Control Financing Authority.
This bill would have expanded the statutory authority of the California Pollution Control Financing Authority (CPCFA) to participate in alternative funding source programs, as specified.
Status: *Died in Senate Appropriations Committee*
Legislative History:

Assembly Floor - (76 - 0)
Asm Appropriations - (15 - 0)
Asm Jobs, Economic Development, and the Economy - (8 - 0)
Asm Banking and Finance - (11 - 0)
Sen Appropriations - (7 - 0)
Sen Governance and Finance - (7 - 0)

SB-797 (Committee on Governmental Organization) - Government finance.

Adds prime-rated commercial paper, issued by a federally- or state-chartered bank or a state-licensed branch of a foreign bank that is approved by the Pooled Money Investment Board (PMIB), to the list of eligible securities for investment of funds in the Pooled Money Investment Account (PMIA). Makes clarifying amendments and deletes obsolete language relating to various bond acts.

Status: *Chapter 249, Statutes of 2015*

Legislative History:

Assembly Floor - (79 - 0)
Asm Appropriations - (16 - 0)
Asm Banking and Finance - (11 - 0)
Senate Floor - (36 - 0)
Sen Governmental Organization - (7 - 0)

Informational Hearings

Assembly Banking and Finance Committee

Innovation and Transformation in Payments Technology

March 16th, 2015
1:30pm,
California State Capitol, Room 444

Overview

The U.S. remains the last developed country reliant on magnetic stripe credit cards (mag stripe), a four-decade old technology. The U.S. is currently on pace to be a full decade behind Europe on the implementation of credit card chip & PIN technology (EMV-Europay, MasterCard, Visa standard). Currently, all face-to-face credit or debit card transactions use a magnetic stripe to read and record account data, and a signature for verification. Under this system, the customer hands their card to the clerk at the point of sale, who "swipes" the card through a magnetic reader. The merchant transmits to the acquiring bank the cardholder's account number and the amount of the transaction. The acquiring bank forwards this information to the card association network requesting authorization for the transaction and the card association forwards the authorization request to the issuing bank. The issuing bank responds with its authorization or denial through the network to the acquiring bank and then to the merchant. Once approved the issuing bank sends the acquiring bank the transaction amount less an interchange fee. This process occurs in a manner of seconds.

This system has proved reasonably effective, but has a number of security flaws, including the ability to get physical access to the card via the mail or via the use of black market card readers that can read and write the magnetic stripe on the cards, allowing cards to be easily cloned and used without the owner's knowledge. The inherit convenience of mag stripe cards is also their inherit weakness.

The terminology and process of a credit card transaction:

Acquirer- A bank that processes and settles a merchant's credit card transaction with the help of a card issuer.

Authorization- The first step in processing a credit card. After a merchant swipes the card, the data is submitted to merchant's bank, called an acquirer, to request authorization for the sale. The acquirer then routes the request to the card-issuing bank, where it is authorized or denied, and the merchant is allowed to process the sale.

Batching- The second step in processing a credit card. At the end of a day, the merchant reviews all the day's sales to ensure they were authorized and signed by the cardholder. It then transmits all the sales at once, called a batch, to the acquirer to receive payment.

Cardholder- The owner of a card that is used to make credit card purchases.

Card network- Visa, MasterCard or other networks that act as an intermediary between an acquirer and an issuer to authorize credit card transactions.

Clearing- The third step in processing a credit card. After the acquirer receives the batch, it sends it through the card network, where each sale is routed to the appropriate issuing bank. The issuing bank then subtracts its interchange fees, which are shared with the card network, and transfers the remaining amount through the network back to the acquirer.

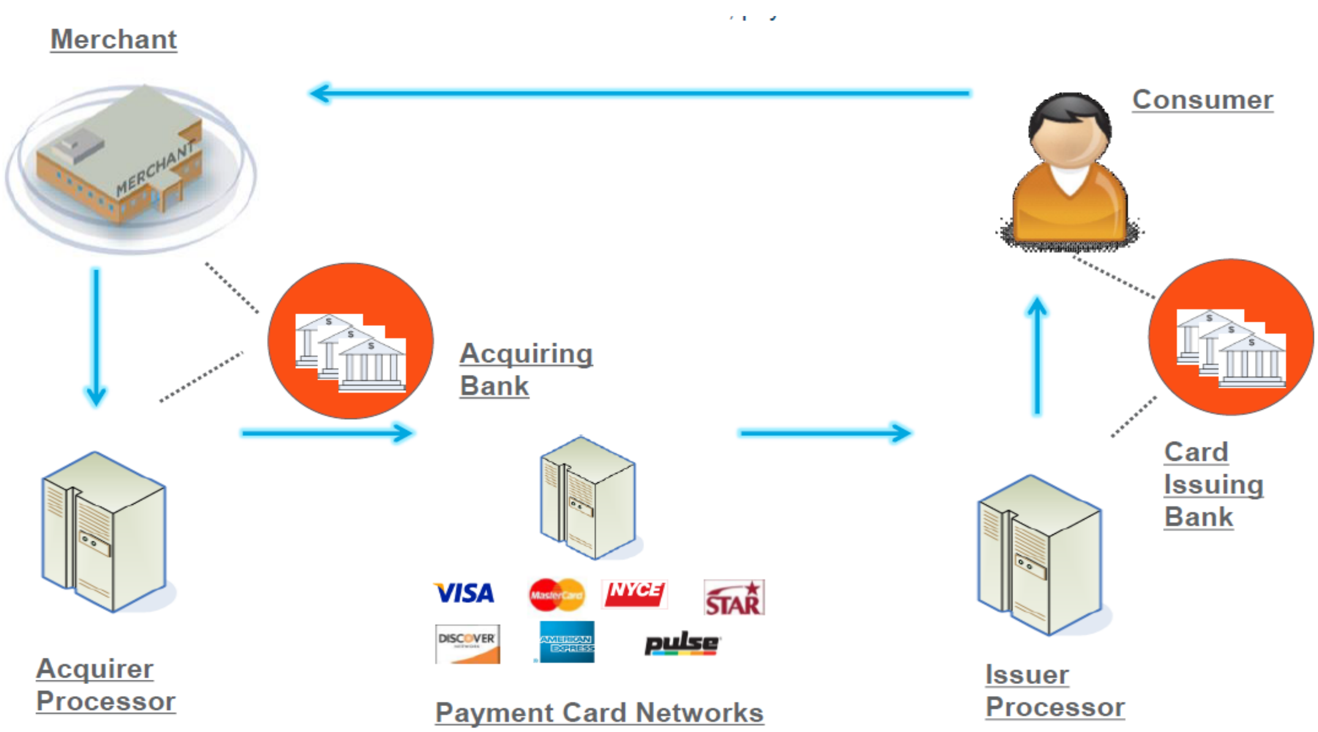
Discount fee- A processing fee paid by merchants to acquirers to cover the cost of processing credit cards.

Funding- The fourth and final step in processing a credit card. After receiving payment from the issuer, minus interchange fees, the acquirer subtracts its discount fee and sends the remainder to the merchant. The merchant is now paid for the transaction, and the cardholder is billed.

Interchange fee- A charge paid by merchants to a credit card issuer and a card network as a fee for accepting credit cards.

Issuer- A financial institution, bank, credit union or company that issues or helps issue cards to cardholders.

Chart: Overview of Typical Credit Card Transaction[1]



[1] Provided by First Data.

- Credit cards are more prevalent than other general-purpose card types. Of the 776 million general purpose cards in force (issued, activated, and not expired) nationally in 2012, 334 million were credit cards, 283 million were debit cards, and 159 million were prepaid cards. Consumers held the majority of general-purpose credit cards - 10 times the number held by businesses (305 million and 28 million, respectively).

- Among general-purpose cards with purchase activity in 2012, consumers preferred debit cards, with an average use of 23 payments per month, compared with an average of 11 payments per month for general-purpose credit cards and 10 payments per month for general-purpose prepaid cards.

- Although the number of ATM cash withdrawals using debit cards and general-purpose prepaid cards dropped slightly, growth in the value of ATM withdrawals continued to exceed inflation over the years. New information on over-the-counter cash withdrawals shows that while the number of ATM withdrawals (5.8 billion) far exceeded the number of over-the-counter withdrawals (2.1 billion) in 2012, the average value of over-the-counter withdrawals, at $715, far exceeded the average value of withdrawals at ATMs ($118).

- In 2012, there were 1 billion ATM cash deposits with an average value of $374, compared with 1.6 billion over-the-counter cash deposits which averaged $1,000.

- Not surprisingly, businesses, not consumers, are the overwhelming users of wire transfers. There were 287.5 million wire transfers—including those sent over large-value funds transfer systems and those made on the books of depository institutions in 2012, with a value of $1,116.3 trillion. Consumers accounted for just 6 percent of all wire transfers by number and 0.14 percent by value. Business customers accounted for the significant majority of both the number and value of wire transfers.

- The number of online bill payments reported by major processors, which included those initiated through online banking websites and directly through billers and settled over ACH, exceeded 3 billion in 2012. Secure online payments, including methods that allow users to enter personal identification numbers (PINs) for debit cards into the computer or that redirect users to use an Internet payment account, totaled more than 1.8 billion in 2012.

- There were more than 250 million mobile payments made using a mobile wallet application, and at least 205 million person-to-person or money transfer payments.

- The number of private-label prepaid transportation payments exceeded all other prepaid card payments combined in 2012: Payments by prepaid transit cards and far-field radio frequency identification (RFID) transponders for auto tolls had reached a combined 9.9 billion payments.

- Checks continue to be written less frequently - more than 90 percent of the decline in total checks was due to reductions in checks for $500 or less, and 45 percent was from reductions in checks for $50 or less.

- As of 2012, there were 287 million consumer transaction accounts with an average value of $8,001, while 33 million business transaction accounts averaged almost $62,000. Meanwhile, there were almost 280 million consumer credit card accounts and almost 29 million business accounts. Credit card balances, which included both current spending and revolving credit, averaged $1,900 for both consumer and business accounts.

EMV: Chip Cards

The U.S. has over 10 million credit card terminals and 1.2 billion credit cards, with less than 2% of cards having chip technology according to the Smart Card Alliance. Annually, credit card fraud equals $11 billion globally, with the U.S. portion amounting to $4.73 billion.[2] The Nilson Report, a credit card industry newsletter, points out that the U.S. accounts for just over a quarter of the global volume of credit card transactions per year, yet accounts for almost 50% of the fraud worldwide.

Credit card chip technology was established in 1994 by Europay International SA. This chip technology is also called EMV, as it was named after its original developers, Europay, MasterCard® and Visa®.

EMV technology is used today in more than sixty countries outside of the U.S. with worldwide usage at 40% of the total credit cards and 70% of the total terminals based on the EMV standard.[3]

A cardholder's data is more secure on the chip-embedded card than on a mag stripe card. Chip-embedded cards support superior encryption and authentication as opposed to mag stripe card making the data on mag stripe cards easier to obtain via fraudulent means. Chip technology counters the static nature of mag stripe cards by implementing technology that creates dynamic values for each transaction in the form of a different verification code for each transaction. EMV cards can be used both online and in face-to-face transactions, both supporting signature and PIN verification with PIN being the dominant method used in Europe. However, while the EMV cards can complete online transactions, those transactions do not have the same level of security as provided by the chip in the face-to-face transaction. In the online scenario the consumer still enters their card data to complete payment with the addition of a PIN. Currently, several European payment technology companies are working to bring the Chip & PIN protection to online transactions.

EMV compatible cards come in three forms. A chip embedded card is inserted into the Point of Sale (POS) terminal and the consumer enters their PIN or uses a signature to complete the transaction. The other way to pay is via contactless cards in which the transaction occurs when the consumer swipes their card within the appropriate distance of the POS terminal that can read the radio frequency identification device (RFID) on the card. The third type of card is a hybrid chip card that allows for both contact and contactless transactions.

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[2] Saporito, Bill. "The Little Strip on Your Debit Card is a Massive Achilles's Heel," Time.com. Jan. 23, 2014

[3] First Data, EMV in the U.S.: Putting It into Perspective for Merchants and Financial Institutions. http://www.firstdata.com/downloads/thought-leadership/EMV_US.pdf

As previously mentioned, the U.S. has lagged behind in the implementation and acceptance of EMV technology. The first U.S. credit card utilizing EMV was issued by United Nations Federal Credit Union (UNFCU) in October of 2010. The primary reason UNFCU issued the card was that many of its members reside outside the U.S. and were in need of a globally accepted card. Outside of the U.S. mag stripe cards are becoming less accepted. Prior to last year's large scale data breaches, most large card issuers in the U.S. (Wells Fargo, JPM Chase, and U.S. Bancorp) have begun to migrate some of their portfolios over to EMV cards, but in limited quantities and targeted toward higher income card holders or those that frequently travel to European countries. Subsequent to last year's data breaches, several financial institutions replaced cardholder's magstripe cards with EMV cards if they were amongst the millions that had their payment data compromised.

On August 9th, 2011 Visa announced an accelerated implementation to EMV technology and established October 1, 2015 as the date when card-present counterfeit fraud liability will shift from issuers to merchant acquirers if fraud occurs in a transaction that could have been prevented with a chip-enabled payment terminal.[4] While the announcement lays a path towards EMV chip card migration, it does not necessarily set a path to chip-and-PIN as Visa will continue to support both signature and PIN cardholder verification methods. The announcement specified incentives and deadlines to urge U.S. merchants to accept both contact and contactless chip-enabled cards. One merchant incentive includes the elimination of the requirement for annual card network compliance validation if 75% of a merchant's transactions originate from chip-enabled terminals. For the largest merchants, savings from an annual compliance validation would average approximately $225,000 a year. Some industry analysts conclude that only 60% of U.S. POS terminals will meet the target date.

The history of European adoption of EMV also took a different course and was instigated for varying reasons, many of those different than the current debate in the U.S. American payments model has been very efficient through the verification of transactions from POS over land line phone lines. In Europe, the inefficient telephone system used for verification, created pressure for card networks to create a secure and localized payment transaction system.

The impact of EMV in the United Kingdom was a large reduction in payment card fraud of 40% since 2000, however the U.K. Payments Administration claims that the failure of the U.S. market to adopt EMV has impacted the U.K. market as counterfeit fraud increased because criminals would copy data from stolen U.K. cards and would in turn use the stolen cards in countries with chip and PIN.[5]

Even in Europe where EMV is over a decade ahead of implementation in the U.S. EMV does not protect against all threats. EMV does not exist for card not present transactions such as online transactions or over the phone, and is unable to protect payment data downstream in the payment process once it has left the POS terminal. Statistics for the U.K. and other EMV countries demonstrate that criminals follow the path of least resistance as fraud migrated away from attacking the card present transaction to target transactions such as online banking, online shopping, mail, and phone orders.[6]

[4] Press Release available at http://corporate.visa.com/newsroom/press-releases/press1142.jsp

[5] First Data, 7

[6] Ibid, 11

EMV is but one step of a multi-layered approach to payment security. Julie Conroy, a senior analysts and fraud expert with Aite Group has stated that the attacker's malware in the Target breach would have penetrated the payment system regardless of what cards were used by consumers.[7] EMV would have prevented the ability of fraudsters to make duplicate cards via stealing data at the POS terminal, but it is very unclear whether it would have prevented the Target and Neiman Marcus breaches specifically. However, EMV would make it difficult for criminals to use the information acquired from a breach to make fraudulent cards.

Obstacles for EMV Implementation:

A factor that contributed to the limited role out of EMV in the U.S. is was that few merchants accept EMV chip-embedded cards and the transition is both costly for issuers and merchants. Most EMV chip cards issued abroad and in the U.S. also contain a mag strip thus allowing acceptance at all U.S. merchants that accept credit cards. Also, up until the recent headline generating data security lapses, most American consumers were unaware of EMV technology or retailers that had EMV capable POS terminals.

According to a First Data report on the implementation of EMV the estimated total costs could be around $8 billion.[8] The costs to financial institutions to issue mag-stripe cards costs as little as 10 cents each, whereas EMV cards can cost up to $1.30 each.[9] Estimates on the costs vary in terms of production and issuance to the customers, but some estimates find that EMV cards could cost, per card, as much as $10-$15 more than existing mag-stripe cards.[10] The Aite Group estimates that the implementation of EMV cards could cut fraud losses in half in the U.S. According to the Nilson Report, U.S. Merchants and banks had 2012 losses of $11.5 billion due to credit card fraud or about 5 cents on every $100 spent and will rise to over $12 billion by 2015.

As mentioned previously, some estimates find that only 60% of businesses will meet the October, 2015 EMV deadline. This means that even during initial phases the marketplace will still have a fair share of mag-stripe cards and EMV capable cards will also still include mag-stripes so that consumers are still able to use their cards at non-EMV compatible merchants. The story of the Netherlands adoption of EMV is telling as they began their transition to EMV in 2007 with a target completion date of 2010. This allowed magnetic stripe cards to stay in the market longer than most other European countries. During the transition, criminals targeted the remaining magnetic-stripe terminals and in 2011 there were 555 successful skimming attacks on payment terminals, up from 176 in 2010.[11] In a telling example of the potential issues that can occur with a transition to EMV, PayPal President David Marcus reported that on a recent trip to the U.K. his EMV enabled card was compromised.[12]

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[7] *Why Target's CEO Changed His Mind About EMV*. American Banker. January 21, 2014
[8] First Data, 13
[9] *The Economics of Credit Card Security*. Washington Post. January 21, 2014.
[10] *Data Breaches Renew Fight Over Credit Card Chip Technology*. USA Today. January 30, 2014.
[11] Sullivan, Ricard. The U.S. Adoption of Computer-Chip Payment Cards: Implications for Payment Fraud.
[12] *PayPal President's Credit Card Hacked for Shopping Spree*. USA Today. February 10, 2014.

The European experience demonstrates that fraud shifts to the weakest links in the payment system during a transition to EMV. In what may be a controversial statement on EMV, a report from the Federal Reserve Bank of Kansas City finds:

> *Fraud for card-present transactions on lost or stolen cards may stay the same or even potentially increase. Many countries that use EMV payment cards do not allow cardholder authentication with signatures. Issuers in the United States, however, appear likely to continue to allow signature authorization on EMV debit and credit card transactions (Heun; Punch). As a result, fraud on lost or stolen cards may not decline in the United States. Fraud may even rise as fraudsters, unable to commit fraud on counterfeit cards, begin to target payments with relatively weak security, such as transactions that allow signature authorization. Fraudsters may put more effort into stealing computer- chip payment cards, knowing that they may be able to commit a few fraudulent transactions using a forged signature before issuers cut off use of the card...*
>
> *...The experience of countries that have adopted computer-chip payment cards shows that EMV payment cards offer capabilities for strengthening authentication and preventing fraud. The degree of payoff from adopting the cards only emerges over time, however, because authentication methods tend to evolve and improve during a transition period. Still, some fraud will migrate to payments with weak authentication capacities, and card issuers will need countermeasures to improve authentication*.

Research and consulting firm Aite Group estimates that U.S. online card fraud will more than double to $6.6 billion from $3.3 billion between 2015 and 2018.

Another factor that will take some time is consumer education. Prior to the recent data breaches most U.S. consumers had not heard of EMV technology as these cards were available to a limited number of consumers that met certain guidelines, such as a frequent traveler. The implementation of EMV will require consumers to become comfortable with a new way to make purchases via inserting the card into the terminal and providing a PIN, or tapping the card against the contactless reader. One card network reported that only 5% of the contactless cards on the market today are ever used for contactless payments.[13] The experience of mobile payments implementation may also be telling for the transition to EMV. One of the often cited reasons for the initially slow adoption of mobile payments usage by consumers is a lack of viewing mobile payments as more convenient than simply swiping their card.

Finally, the form of EMV technology may offer additional points of concern and disagreement amongst industry participants. The form of EMV offered will be up to each issuer so that the credit card market in the U.S. will see a mix of Chip & PIN and chip & signature cards. Chip & signature cards offer less protection than those that require a PIN because should someone (other than the cardholder) get physical access to the card the signature is easily forged.

[13] First Data, 16

Estimates are that 70% of credit cards and 40% of debit cards will use EMV technology by the end of 2015, though the rollout of upgraded POS terminals may take until the end of the decade.[14] Whatever the timeline may be urgency is necessary as security experts predict increased data breaches as hackers close in to exploit the current payment system before the door closes.[15]

Additional Payments Security:

EMV technology is a vital piece of a larger puzzle in protecting payment information as it does not alleviate the "need for secure passwords, patching systems, monitoring for intrusions, using firewalls, managing access, developing secure software, educating employees and having clear processes for handling of sensitive payment card data."[16]

Point-to-point encryption (P2PE) technology helps merchants and acquirers protect payment card data within their systems by encrypting sensitive cardholder information. Because the card data can only be accessed, or unscrambled, with decryption keys held securely by the acquirer, gateway or card network, cardholder information is protected within the payment processing environment.

P2PE ensures sensitive credit and debit card data is protected from first card swipe, while in transit, all the way to the payment processor. This technology is also referred to as end to end encryption, or E2EE.

State of the art encrypting devices scan and encrypt cardholder information prior to performing an electronic payment transaction. These sophisticated devices use Triple DES Encryption and DUKPT key management technology to encrypt and transmit cardholder data securely over any network. The encrypted cardholder data being transmitted is NOT equivalent to the original cardholder data in any way. Even if the data were to be intercepted, it would be useless to data thieves.

Tokenization

Tokenization has advantages for both merchant and service providers. Tokenization is software-based and replaces the cardholder's primary account number (PAN) with a randomly-generated proxy alphanumeric number ("token") that cannot be mathematically reversed and is used for long-term storage or for use as a transaction identifier. From a service provider's perspective, being a software-only technology, it is fairly easy to institute.

For recurring payments from a merchant's standpoint, tokenization is ideal. For these type of payments, the card number is only on the merchant's network "in flight" during the initial transaction which can now be encrypted and protected using P2PE but beyond that, the merchant uses the token that represents the original card for subsequent payments or to

[14] Preparing for Chip-and-PIN Cards in the United States. The New York Times. December 2, 2014
[15] Experian 2015 Data Breach Industry Forecast.
[16] Statement of Troy Leach, Chief Technology Officer, Payment Industry Security Standards Council. *Before the Committee on Banking, Housing, and Urban Affairs, Subcommittee on National Security and International Trade and Finance United States Senate*. February 3, 2014.

track customer transactions for marketing purposes. A myriad of targeted marketing programs can be developed by the merchant using cardholder purchase history data in a tokenized fashion in the merchant's database to, for instance, project what new products may complement those the consumer previously purchased.

One of the major benefits of the tokenization implementation planning process is that it offers the opportunity for merchants to potentially get a head start in compliance with PCI version 3.0, which requires an annual assessment of the locations and flows of cardholder data. Locating all the cardholder data within a merchant's location and identifying who should have access to it could help merchants get ahead of future PCI compliance by re-engineering the logical controls and restrictions to tokenized data.

Tokenization is also a major part of mobile payments security. In the case of mobile payment applications like Square, the consumer's face is the token because it is shown to the merchant but the actual payment information is secure and never shared. Apple Pay uses tokenization where the actual credit card number is removed and replaced with a randomly generated number. The number, or token, can expire after one purchase or a after a specific number of transactions. This process prevents the storage of payment information by retailers as their systems never actually see the customer's credit card information.

Mobile Payments & Mobile Banking

The Aite group forecasts that U.S. mobile payments will reach $214 billion in gross dollar volume in 2015, a monumental rise from $16 billion in transactions in 2010. Consumer behavior has drastically changed with the smartphone becoming a crucial part of everyday activities. Four out of every five shoppers use smartphones to shop and 85% of all merchants say that mobile commerce is a focus up from 68% in 2012.[17] In the U.S. over $4.6 billion worth of transactions are made using mobile money every month accounting for 224 million monthly transactions with 30 million active users, 520,000 agents, and 150 mobile money services.[18] In spite of these numbers the Yankee Group, an information technology research and advisory company, only 16% of mobile users used a mobile wallet to make an in store purchase.

Consumers currently can make three types of payments using a smartphone or tablet computer. The first is a person-to-person transfer initiated by a mobile device that could include non-commercial payments from one person to another, or commercial payments to a small scale merchant. Second, is for goods or services purchased over the internet on a mobile device. The third option is at POS device initiated from a mobile device at a physical location. These payments can be made using a variety of technologies such as a wallet system that may utilize a smart phone based application to generate barcodes, or a QR Code that allows the user to pay for something from a funding source associated with the mobile wallet. Other options connect a virtual wallet with an email address or username and password. The potential security benefit to a consumer using a mobile payment application

[17] *Simplicity is the Ultimate Sophistication: The Future of Mobile Payments*. Oracle. October 2014.
[18] Ibid. 4

is that the consumer's underlying payment data can be shielded from the retailer's payment system.

The aforementioned systems can further be divided into two main categories of mobile payment, Proximity Payments and Remote Payments. Proximity payments are those that occur when the technology is embedded in, attached to, or displayed on the purchaser's mobile device and interfaces with the merchants POS. Examples of this are Apple Pay, Google Wallet and the Starbucks payment application. A remote payment occurs when the purchaser uses a mobile device to initiate a payment to a merchant or other payee without regard to the proximity of the POS or the payee.

Mobile payments by the numbers:

- 55% of US millennial smartphone owners who use mobile payments prefer to have a unified app that can be used in multiple stores while integrating individual store coupons and loyalty programs (Customer Engagement Via Mobile Wallets: There’s No Way It Won’t Become a Norm LOYALTY360 Published: 12/08/2014)

- "Pre-Apple Pay, nearly a quarter of smartphone users had already used a mobile payment app at some point. And we know that if anyone can drive new technology adoption, it's Apple" - Robyn Hannah, VP, PR and Communications, PunchTab

- 29% of US smartphone owners who have used mobile payment apps to make a purchase have used the Starbucks app, compared to 25% for Google Wallet, 10% for Visa Checkout, and 9% for PayPal Wallet (Customer Engagement Via Mobile Wallets: There’s No Way It Won’t Become a Norm LOYALTY360 Published: 12/08/2014)

- 13% of North American millennials use their smartphones to make payments at merchant locations at least once per week, and 26% expect to do so by 2020 (Digital Payment Technologies Convenient for Customers LOYALTY360 Published: 10/30/2014)

- 18% of North American consumers expect to use digital currencies to complete a mobile payment transaction at least weekly by 2020. (Digital Payment Technologies Convenient for Customers)

- 8% of North American consumers use digital currencies to complete a mobile payment transaction at least weekly. (Digital Payment Technologies Convenient for Customers)

- "Millennials are most likely of any age group to use a smartphone to make a mobile payment, and are in fact driving the adoption of new payments technologies" - Matthew Friend, Accenture Payment Services

- There will be 516 million mobile users of near field communication contactless payment services by the end of 2019, up from 101M in 2014. (*Apple Pay and HCE To*

Push NFC Payment Users to More Than 500 Million by 2019, Juniper Research Published: 10/28/2014)

- 36% of Americans who use mobile payments have done so to pay household bills. (The Modern Wallet: Mobile Payments are Making Life Easier, NIELSEN Published: 07/04/2014)

Ironically, with the pace of technological development, specifically in California, the United States lags behind the developing world on mobile payment use. Several developing markets are bypassing traditional banking all together and jumping straight to mobile banking options. Merchants, acting agents for traditional banks, in small villages use mobile phones and card readers for customer deposits, withdrawals and money transfers. Keyna is a leader in using this technology for mobile banking as 12 million people send and save money using M-Pesa a completely telephone based banking system.

Mobile payment platforms continue to be an area of fierce competition and development as various industries have created their own mobile wallet applications. These developments change monthly as industries pivot into new directions and philosophies in the payments space. Just recently, Softcard, a joint venture between T-Mobile, AT&T and Verizon sold its technology to Google. The mobile carriers had an edge in pushing Softcard, formally the poorly named ISIS wallet, as it was often preloaded on mobile phones and would actually block the NFC chip of such phones to prevent the user from using another wallet service such as Google Wallet. With Google purchasing the technology of Softcard they are on a mission to offer a competing wallet on par with Apple Pay.

Not to be left out of this mobile payment arms race, Samsung is rolling out a new payments platform with the release of its newest Galaxy phone model called Samsung Pay. Samsung purchased a company called LoopPay to make its new platform possible. The company uses a patented technology called Magnetic Secure Transmission (MST) to turn payment terminals into contactless readers. Samsung Pay could be accepted at millions of terminals and merchants may not even notice. This technology allows users to pay using almost any magnetic stripe payment gateway, which as you know sits on the countertop of just about every retail establishment in the US. MST broadcasts data magnetically, making it so you can send your payment credentials just by tapping your phone to the side of the terminal you would normally swipe your card in, and no additional tech is required from the vendor. As far as the register behind the counter is concerned, you just swiped your card.

Retailers have jumped into the mobile payments mix with a project called CurrentC, backed by Merchant Customer Exchange (MCX). CurrentC is estimated to roll out over the next year and in a preempted strike several retailers (Rite Aid and CVS) who are members of MCX have disabled the NFC readers in their stores to block the use of Apple Pay. The motivation behind CurrentC is to remove credit card infrastructure from the transaction in order to remove the fees paid by merchants for credit card transactions. While Apple Pay and other NFC based apps provide convenience and potentially layers of encryption for a transaction, NFC based wallets still rely on the existing payments network. With Apple Pay users take a photo of their credit cards, storing this information on their phone. When checking out the consumer holds their iPhone to the NFC POS terminal and then authenticate the transaction via the Touch ID sensor on the phone. The means to the transaction has changed but the behind the scene processing still operates the same as if the consumer used their plastic credit card. CurrentC changes this by eliminating the credit card from the equation and instead links it to the consumer's checking account. In order to pay, the customer scans a QR code or the cashier scans a QR code generated on the customer's phone. If the account information were to be stolen a consumer would have less protection because the funding mechanism was an Automated Clearing Housing (ACH) payment. Under certain conditions, a credit card holder has certain protections in the case of a dispute with the merchant. Additional protection is provided for credit card holders from their card issuers if the ordered merchandise is never delivered or different merchandise is delivered than what is ordered. No comparable protection is provided for ACH transactions or debit card users. While a consumer's liability for unauthorized transactions is generally limited, the liability can increase for debit card and ACH users if they do not provide timely notice of unauthorized transactions and there continue to be unauthorized transactions on the account.

Table 1: Mobile Payments Technologies	
Near Field Communications	Wireless protocol that allows for encrypted exchange of payment credentials and other data at close range.
Cloud Based	Leverages mobile connection to the Internet to obtain credentials not stored on the mobile device.
Image Based	Coded images similar to barcodes used to initiate payments. Credentials may be encrypted within image or stored in cloud.
Carrier Based	Payments billed directly to mobile phone account. Merchants paid directly by mobile carrier, bypassing traditional payment networks.
Proximity Based	Geolocation used to initiate payments. Merchant will identify active users within range and verify identity. Credential exchange is cloud-based.
Mobile P2P	Payment initiated on mobile device using recipient's email address, mobile phone number, or other identifier. Payment is via ACH, card networks, or intra-account transfer.

FIDC, Supervisory Insights - Winter 2012, *Mobile Payments: An Evolving Landscape*

Table 3: Laws and Regulations That Apply to Mobile Payments Transactions		
Law or Regulation / Description: Electronic Fund Transfer Act (EFTA) / Regulation E *Establishes rules for electronic fund transfers (EFTs) involving consumers.*		
Coverage: Generally includes any "transaction initiated through an electronic terminal, telephone, computer, or magnetic tape that instructs a financial institution either to credit or debit a consumer's account." This includes transactions such as debit card transactions, direct deposits and withdrawals, and automated teller machine (ATM) transactions. The regulation generally applies to financial institutions, but certain provisions apply to "any person."	**Applicability to Mobile Payments**: Applies when the underlying payment is made from a consumer's account via an EFT.	**Key Obligations / Other Information**: The rule establishes consumer rights to a number of disclosures and error resolution procedures for unauthorized or otherwise erroneous transactions. The disclosures include upfront disclosures regarding, among other things, the terms and conditions of the EFT service and how error resolution procedures will work.
Law or Regulation / Description: Truth in Lending Act (TILA) / Regulation Z *Establishes rules regarding consumer credit; intended to help consumers understand the cost of credit and compare credit options.*		
Coverage: Generally applies to "creditors" that offer or extend credit to consumers and includes both open-end and closed-end credit products, including credit cards.	**Applicability to Mobile Payments:** Applies when the underlying source of payment is a credit card (or other credit account covered by TILA and Regulation Z).	**Key Obligations / Other Information**: Creditors are required to provide disclosures to consumers describing costs; including interest rate, billing rights, and dispute procedures.
Law or Regulation / Description: Truth-in-Billing *Requires wireless carriers to provide certain billing information to customers.*		
Coverage: Applies to wireless carriers.	**Applicability to Mobile Payments**: Applies when mobile payment results in charges to mobile phone bill.	**Key Obligations / Other Information**: Wireless carriers must provide clear, correct, and detailed billing information to customers. This includes a description of services provided and charges made.
Law or Regulation / Description: Unfair, Deceptive, or Abusive Acts or Practices (UDAP) under the Federal Trade Commission (FTC) Act /Unfair, Deceptive or Abusive Acts or Practices (UDAAP) under the Consumer Financial Protection Act of 2010 *Prohibits "unfair or deceptive acts or practices in or affecting commerce."*		
Coverage: Applicable to any person or	**Applicability to Mobile**	**Key Obligations / Other Information**:

entity engaged in commerce. Made applicable to banks pursuant to Section 8 of the Federal Deposit Insurance Act.[16]	**Payments**: Applies to all mobile payments regardless of underlying payment source.	Prohibits “unfair or deceptive acts or practices in or affecting commerce.” The Dodd-Frank Act also added the concept of “abusive” practices to “unfair” or “deceptive” ones, and gave the Consumer Financial Protection Bureau (CFPB) authority to further define abusiveness.
Law or Regulation / Description: Gramm-Leach-Bliley Act (GLBA) Privacy and Data Security Provisions *Establishes rules regarding consumer privacy and customer data security.*		
Coverage: The privacy rules and data security guidelines issued under GLBA apply to “financial institutions,” which include depository institutions as well as nonbanks engaged in financial activities.	**Applicability to Mobile Payments**: Applies when a financial institution handles information of a “consumer” or “customer.”	**Key Obligations / Other Information**: Financial institutions are required to provide consumers with certain notices regarding the privacy of nonpublic personal information and allow them to opt out of certain types of information sharing. The GLBA data security provisions give guidance on the appropriate safeguarding of customer information.
Law or Regulation / Description: Federal Deposit Insurance or NCUA Share Insurance *Protects funds of depositors in insured depository institutions and of members of insured credit unions in the event of failure of the institution.*		
Coverage: Applies to “deposits” and “accounts” as defined in laws and regulations of the FDIC and National Credit Union Administration. These include savings accounts and checking accounts at banks and share accounts and share draft accounts at credit unions.	**Applicability to Mobile Payments**: If the funds underlying a mobile payment are deposited in an account covered by deposit insurance or share insurance, the owner of the funds will receive deposit or share insurance coverage for those funds up to the applicable limit.	**Key Obligations / Other Information**: Deposit insurance or share insurance does not guarantee that a consumer’s funds will be protected in the event of a bankruptcy or insolvency of a nonbank entity in the mobile payment chain.
Note: This table is not exhaustive, and other laws, regulations, and policies may apply.		

Virtual Currency

Recent headlines concerning virtual currency have been dominated by Bitcoin with some of this attention resulting from negative publicity. The high profile *Silk Road* case in which federal law enforcement officials arrested the operator of an online illegal drug market place that facilitated the sale of drugs and other illegal goods through acceptance of Bitcoins. Bitcoins were used because it is a decentralized currency allowing users to be pseudonymous to some extent, even though every Bitcoin transaction is logged. Bitcoin is not the first, nor the only virtual currency. Numerous models of virtual currency have sprouted up over the last decade, and this growth has inspired additional questions by government officials and policy makers.

Bitcoin has received its share of negative attention from its wild price fluctuations, awareness against Bitcoin "Wallets" (as the individual software applications that manage bitcoin holdings) to being credited with being the currency of choice for criminal activity. As to the latter attribution, cash money is still the dominant and preferred source of anonymous payment for illegal activities. Some of the attention, specifically in relation to the risk associated with storing virtual currency has raised the attention of state regulators across the country.

Even though the core program that runs bitcoin has resisted six years of hacking attempts, the successful attacks on associated businesses have created the impression that bitcoin isn't a safe way to store money. Bitcoins exist purely as entries in an accounting system—a transparent public ledger known as the "blockchain" that records balances and transfers among special bitcoin "addresses." With bitcoin, the balances held by every user of the monetary system are instead recorded on a widely distributed, publicly displayed ledger that is kept up-to-date by thousands of independently owned, competing computers known as "miners."

What does a real world transaction look like such as buying a cup of coffee at your local coffee shop? If you pay with a credit card, the transaction seems simple enough: You swipe your card, you grab your cup, and you leave. The financial system is just getting started with you and the coffee shop. Before the store actually gets paid and your bank balance falls, more than a half-dozen institutions—such as a billing processor, the card association your bank, the coffee shop's bank, a payment processor, the clearinghouse network managed by the regional Federal Reserve Banks—will have shared part of your account information or otherwise intervened in the flow of money. If all goes well, your bank will confirm your identity and good credit and send payment to the coffee shop's bank two or three days later. For this privilege, the coffee shop pays a fee of between 2% and 3%.

Now let's pay in Bitcoin. If you don't already have bitcoins, you will need to buy some from one of a host of online exchanges and brokerages, using a simple transfer from your regular bank account. You will then assign the bitcoins to a wallet, which functions like an online account. Once inside the coffee shop, you will open your wallet's smartphone app and hold its QR code reader up to the coffee shop's device. This allows your embedded secret password to unlock a bitcoin address and publicly informs the bitcoin computer network that you are transferring $1.75 worth of bitcoin (currently about 0.005884 bitcoin[19]) to the coffee shop's address. This takes just seconds, and then you walk off with your coffee. Next, in contrast to the pay with credit/debit system, your transaction is immediately broadcast to the world (in alphanumeric data that can't be traced to you personally). Your information is then gathered up by bitcoin "miners," the computers that maintain the system and are compensated, roughly every 10 minutes, for their work confirming transactions. The computer that competes successfully to package the data from your coffee purchase adds that information to the blockchain ledger, which prompts all the other miners to investigate the underlying transaction. Once your bona fides are verified, the updated blockchain is considered legitimate, and the miners update their records accordingly. It takes from 10 minutes to an hour for this software-driven network of computers to formally confirm a transfer from your blockchain address to that of the coffee shop—compared with a two- to three-day wait for the settlement of a credit-card transaction. Some new digital currencies are able to finalize transactions within seconds. There are almost zero fees, and the personal information of users isn't divulged. This bitcoin feature especially appeals to privacy advocates: Nobody learns where you buy coffee. The advantages of digital currency are far more visible in emerging markets. It allows migrant workers, for example, to bypass fees that often run to 10% or more for the international payment services that they use to send money home to their families. Although many companies now accept bitcoin (the latest and biggest being Microsoft Corp.), global usage of the digital currency averaged just $50 million a day in 2014. Over that same period, Visa and MasterCard processed some $32 billion a day. The market capitalization for BitCoin is almost at $4 billion with virtual currency Ripple the next largest at over $340 million.

[19] As of March 12, 2015

FinCEN Issues Guidance on Virtual Currencies

FinCEN issued interpretive guidance earlier this year to clarify how the Bank Secrecy Act (BSA) and FinCEN regulations apply to users, administrators and exchangers of virtual currencies. Under the regulatory framework, virtual currency is defined as having some but not all of the attributes of "real currency" and therefore, virtual currency does not have legal tender status in any jurisdiction. Specifically, the FinCEN guidance addresses convertible virtual currency which either has a real currency equivalent value or serves as a substitute for real currency.

The roles of persons (including legal entities) involved in virtual currency transactions are defined by FinCEN as follows:

- User: A person who obtains virtual currency to purchase goods or services
- Exchanger: A person engaged as a business in the exchange of virtual currency for real currency, funds or other virtual currency
- Administrator: A person engaged as a business in issuing into circulation a virtual currency and who has the authority to redeem and withdraw from circulation such virtual currency

A person, or legal entity, may act in more than one of these capacities. Further, it is important to note that "obtaining" virtual currency covers much more than the scenario of a "user" who merely purchases virtual currency. Depending on the model of the particular currency, a party could "obtain" virtual currency through various acts including earning, harvesting, mining, creating, auto-generating, manufacturing or purchasing.

The threshold issue is whether actions will subject a person or legal entity to BSA's registration, reporting and recordkeeping regulations that apply to money services businesses (MSBs). A user who obtains convertible virtual currency and uses it to purchase real or virtual goods or services is not subject to MSB compliance because such activity does not meet the definition of "money transmission services" and the user would not be a "money transmitter."

However, an administrator or exchanger engages in money transmission services and, as a result, is a "money transmitter" under FinCEN definitions by (1) accepting and transmitting convertible virtual currency or (2) buying or selling convertible virtual currency. As a money transmitter, the administrator or exchanger would generally be subject to MSB reporting and recordkeeping.

Further, the FinCEN guidance expressly addresses the category of de-centralized virtual currency – the Bitcoin model – and states that "a person is an exchanger and a money transmitter if the person accepts such de-centralized convertible virtual currency from one person and transmits it to another person as part of the acceptance and transfer of currency, funds, or other value that substitutes for currency."

In the area of foreign exchange, accepting real currency in exchange for virtual currency is not subject to FinCEN regulations applicable to "dealers in foreign exchange" since a forex transaction involves exchanging the currency of two countries and virtual currency does not constitute legal tender as a currency of a country.

Last year, the Legislature passed and the Governor signed AB 129 (Dickinson) which clarified California law to ensure that alternative currency, including virtual currency would not be potentially deemed illegal tender. California continues to lead the way on these issues as this year Assembly Banking and Finance Committee Chair Matt Dababneh has introduced AB 1326 which would require licensing and capitalization requirements for some entities that offer virtual currency exchange services. The goal behind this legislation is to provide protections for users of virtual currency when they store that currency with a service that offers a digital wallet function. With greater oversight and protections virtual currency may gain even greater mainstream participation.

For a detailed review of Bitcoin and virtual currency see Bitcoin: A Primer for Policy Makers either attached to this background or available at http://mercatus.org/sites/default/files/Brito_BitcoinPrimer_v1.3.pdf

Joint Hearing of the Assembly Committee on Housing and Community Development
and the Assembly Committee on Banking and Finance

"First-Time Homebuyers: Housing Policies for New Realities"
Wednesday, March 25, 2015
9:30am-12pm
State Capitol, Room 126

Introduction & Background

In early 2007 it became clear that the U.S. housing market was in deep trouble as several major mortgage lenders filed for bankruptcy, others teetered on the brink of collapse, and market liquidity vanished. The pain of the foreclosure crisis was widely shared by homeowners, the financial markets, investors, and others. Foreclosures blighted neighborhoods, put financial pressure on families, and drove down local real estate values. Consumers, made more cautious by a crippled housing market, spent less freely, curbing the economy's growth.

Has the pendulum swung too far?

When evaluating the current difficulties in the housing market it is important to note the effect of the subprime mortgage crisis that coincided, some say triggered, the Great Recession. The years leading up to the 2007 crash saw unprecedented housing price appreciation, market liquidity, and access to easy credit. In the sixteen years prior to the collapse, 1990 to 2006, the Mortgage Backed Securities (MBS) market grew by seven fold to its height of two trillion dollars through a combination of Government-Sponsored Enterprises (GSEs) and private label MBS issuance. Subprime mortgages with creative rates and terms were over 20% of the first-time buyer market. Access to mortgage credit was easy and a popular saying from the era was "If they can fog a mirror they can get a loan." Everyone, from government, buyers, sellers, brokers, lenders, and everyone else in the mortgage market all assumed that housing prices would rise forever and that young people buying homes were not just buying property, but were purchasing their own ATM machine. It was not uncommon for borrowers in their early twenties, yet to finish college or start a career, to buy homes with no money down and little to no established credit. The financial cultural narrative of the early to mid-2000's was to buy the house now and worry about the finances later. Like all parties that last too long and end abruptly, the participants were left stunned and full of regret.

The collapse of the housing market and the recession that followed dried up much of the mortgage market except what was supported by the GSEs. Due to market dynamics and efforts to provide greater oversight and reform of the mortgage market the credit pendulum has swung in the opposite direction. Underwriting standards are more restrictive, credit scores actually matter and regulators are regulating. These things alone should not lock-out buyers from the market, but it may take some time to bring lending standards to a neutral position that allow first- time buyers access while also managing risk. However, it is important that first-time homeownership not be measured against the excesses of the housing bubble which created artificial levels of homeownership. Perhaps the most difficult job of policy makers and private markets will be to determine what makes a healthy market for homeownership.

In 2015 California can still feel the ramifications of the housing crisis. Overall homeownership rates have declined. According to the recent U.S Census, California's homeownership rate dropped quickly in the fourth quarter (Q4) of 2014, falling over a percentage point to 53.2%. This is down from 54.6% one year earlier. The homeownership rate has plummeted from its 60.7% peak in 2006 to its present level. Hispanic and African American families have seen an alarming decline as well in the last several years, from 47% in 2005 to 42% in 2013 for Hispanics and 40% to 33% for African Americans.

The evident lack of first-time homebuyers is slowing the housing recovery process. It seems millennials in California are currently staying out of the housing market. According to Veros Real Estate Solutions, (who provide tools for comprehensive property valuation and risk assessment to mortgage lenders, servicers, rating agencies and the investment community) the percentage of first-time homebuyers has dropped to 33% down significantly from the long-term national average of 40% (dating back to 1981), a 27 year low. In addition, the lack of first-time homebuyers impacts the rental housing market as well by creating greater competition for a finite number of rental units. About 45% of all California households –5.6 million households -- are renters. A number of factors contributing to the decrease of homeownership, including student debt, affordability, lack of interest, and convenience of living with parents.

The average millennial is about 24 years old and makes only about $35,000 a year. In addition, millennials are technologically savvy, dependent on their smart phones and social media. Millennials not purchasing homes creates a stagnant housing market which then impacts financial institutions (mortgage lenders), communities, and families. According to the California Association of Realtors, a study found that 45% of college-educated millennials have moved back in with their parents because they can't find a job or the one they have doesn't cover student loan payments and a place to live. The biggest factor contributing to this problem is most likely student debt. According to Jonas Moe, vice president of product strategy at Ellie Mae, "For the first time, our accrued student debt is higher than our credit card debt."

Another issue for millennials is that their credit history is unestablished but college has left them with an extreme amount of debt. A huge number of millennials also do not earn enough income to be able to afford a home in California. According to the recent report released by the Legislative Analyst's Office, titled "California's High Housing Costs: Causes and Consequences," an average California home costs $440,000, about two-and-a-half times the average national home price ($180,000) and California's average monthly rent is about $1,240, 50% higher than the rest of the country ($840 per month.)

The California Association Realtors released a survey based on millennials in October, 2014 which found:

- Of the millennial renters, the majority (67%) rent because they can’t afford to purchase a home.

- Like any other home buying segments, millennials are concerned about high home prices and affordability, with nearly half (45%) citing those as their biggest concern about homeownership.

- One in two millennial renters has student debt, but most don't feel it is preventing them from qualifying for a mortgage. Additionally, more than four in 10 (43%) don't have debt that would prevent them from buying a home.

- Even though many millennials saw their parents struggle through the recession, more than half (59%) said the housing crisis didn't affect their attitude toward homeownership being a good investment.

- Despite the stereotypes that these young adults mostly seek urban living with a high walkability factor, millennials said they prefer single-family homes on large lots in the suburbs, with two out of three (67%) indicating they plan to purchase a single-family detached home, while only 12% said they plan to purchase a townhome or condominium.

- While they aspire toward homeownership, the majority was uncertain or doubtful they could obtain a mortgage now, with 45% saying they were not sure, and 33 % saying they would not be able to obtain a mortgage now.

Who is your Typical Millennial?

- Nearly 3/10 of millennials have a college degree.
- One quarter of millennials are students and only 1/3rd millennials have full time jobs.
- Majority rent (41%) or lives with their parents (36%), only 1/5 are home owners.

Renters

- Two-fifths of millennials are currently renting.
- Majority rent instead of buying because they cannot afford to buy, but most expect to buy a home in the same county or same neighborhood within 5 years.
- Contrary to common belief, detached single-family homes and big lots of land are the preferences of prospective buyers.
- The majority of millennials value home ownership, giving an average importance rating of home ownership of 7.1 on a scale of 1-10.

Buyers

- One-fifth of millennials are homeowners. Twenty-eight percent of those homeowners inherited their properties. Nearly 9/10 are first-time buyers.
- Affordability is the main reason for buying a home. Most millennial homeowners did not buy a home sooner due to a lack of urgency.
- They are optimistic about future home prices, with 59% expecting prices will be higher in a year and 63% think prices will go up in 5 years.

Financing

- The majority of millennial home buyers obtained financing. Of the 17% who paid cash, most of those funds came from personal savings.
- The average down payment for those who obtained financing was 26%.
- More than half found it easy to acquire financing, with an average difficulty rating of 4.4 on a 10 point scale (10 = extremely difficult).

Buyer/Agent Relationship

- Millennial homeowners preferred communicating with their agent through email and telephone and those expectations were met, for the most part. Agents also met expectations on response time, with most responding to their clients within the time frame the client expected.
- Buyers were mostly satisfied with the home buying process and with their agent because the agent worked hard and negotiated a good deal.
- Millennial buyers found that they needed the most assistance from agents in finding the right home and negotiating the purchase price. Many felt they received a positive value from hiring an agent and would work with that agent again.

<u>State Action for First-Time Homebuyers</u>

The state invests in multiple programs for first-time homebuyers. Listed below are a few of the state agencies that administer these programs.

The California Housing Finance Agency (CalHFA)

Established in 1975, CalHFA was chartered as the state's affordable housing bank to make low-interest rate loans through the sale of tax-exempt bonds. CalHFA is a self-supporting state agency, and its bonds are repaid by revenues generated through mortgage loans. It provides funding for both single family homeownership and multifamily rental properties.

As part of its single family homeownership profile, CalHFA provides low interest rate mortgages to low and moderate income homebuyers, as well as downpayment and closing costs assistance. Eligibility requirements, such as income limits, vary depending on the program. For the purpose of first-time homebuyer assistance, a "first-time homebuyer" is defined as someone who has not owned and occupied their own home in the last three years. Programs such as the California Homebuyers Downpayment Assistance Program (CHDAP) help first-time homebuyers achieve homeownership by providing "silent" second-mortgage loans to reduce the principal and interest payments on a first mortgage. The CHDAP provides a deferred-payment junior loan – up to 3% of the purchase price, or appraised value, whichever is less, to be used for their down payment and/or closing costs. This program may be combined with a CalHFA or non-CalHFA, first mortgage loan. Buyers generally access these loan funds through their lender.

Another program offered by CalHFA, the Mortgage Credit Certificate (MCC) program, is also geared towards first-time homebuyers. The MCC Tax Credit is a federal credit which can reduce potential federal income tax liability, creating additional net spendable income which borrowers may use toward their monthly mortgage payment. This MCC Tax Credit program may enable first-time homebuyers to convert a portion of their annual mortgage interest into a direct dollar for dollar tax credit on their U.S. individual income tax returns. Exceptions to the first-time homebuyer requirement are 1) the home is located in a federally designated targeted area or 2) the homeowner is a qualified veteran pursuant to the Heroes Earning Assistance and Relief Tax Act of 2008.

Department of Housing and Community Development (HCD)

The role of HCD, according to its mission statement, is to "[p]rovide leadership, policies and programs to preserve and expand safe and affordable housing opportunities and promote strong communities for all Californians." HCD is involved in numerous housing programs and policies throughout California, and administers more than 20 programs that award loans and grants for the construction, acquisition, rehabilitation and preservation of affordable rental and ownership housing, homeless shelters and transitional housing, public facilities and infrastructure, and the development of jobs for lower income workers. Generally, these loans and grants are made to local public agencies, nonprofit and for-profit housing developers, and service providers. In many cases these agencies then provide funds to individual users.

For example, as part of Proposition 46, the CalHOME Program provided funds for homeownership programs to assist low- and very low-income households become or remain homeowners. Funds were allocated in either grants to programs that assist individuals or loans that assist multiunit homeownership projects. Grant funds were used for first-time homebuyer downpayment assistance, home rehabilitation, homebuyer counseling, home acquisition and rehabilitation, or self-help mortgage assistance programs, or for technical assistance for self-help and shared housing homeownership. Loan funds were used for purchase of real property, site development, predevelopment, and construction period expenses incurred on homeownership development projects, and permanent financing for mutual housing or cooperative developments.

Franchise Tax Board (FTB): New Home/First-Time Homebuyer tax credit program

Homeownership is a public goal under the existing tax structure, and the state New Home/First-Time Homebuyer tax credits reflected this goal. In 2009, the Legislature passed and the Governor signed SBX2 15 (Ashburn, Chapter 11, Statutes of 2009), which authorized a $10,000 tax credit (or 5 percent of the purchase price if that amount is lower) for taxpayers purchasing qualified homes after March 1, 2009 and before March 1, 2010. The legislation allocated $100 million in credits for previously unoccupied homes that serve as the taxpayer's principle residence. The FTB allocated all of the available credits by July 2, 2009, on a first-come, first-serve basis.

In 2010, AB 183 (Caballero/Ashburn, Chapter 12, Statutes of 2010) reauthorized this tax credit to provide an additional $100 million in credits for taxpayers purchasing previously unoccupied homes between May 1, 2010 and December 31, 2010, or any taxpayer who purchases a qualified home on and after December 31, 2010, and before August 1, 2011, pursuant to an enforceable contract executed on or before December 31, 2010. An additional $100 million in credits were also authorized for first-time homebuyers purchasing existing homes in the same time frames. The FTB fully allocated the $100 million allotted for the First-Time Homebuyer credit, and allocated $94 million for the New Home credit.

Federal Action for First-Time Homebuyers

Fannie Mae and Freddie Mac/Government Sponsored Enterprise (GSEs)

In October of 2014, the GSEs announced that they will allow loan-to-value (LTV) ratios as high as 97%. This is an effort to make more homeownership more accessible since a down payment may be the biggest hurdle for a potential buyer. This change means buyers can put down just 3% instead of the previous 5% down payment requirement that was in place for conforming mortgage loans. Investment properties and second homes are not eligible.

Eligibility requirements for Fannie Mae's 97 % LTV Offering:

- At least one borrower must be a first-time homeowner (no ownership interest in last 3 years)
- Available on one-unit principal residences only
- Maximum loan-to-value ratio 97%
- No income limit requirements for standard purchases
- Reserves may be gifted
- Only fixed-rate loans with terms up to 30 years are eligible
- No high-balance loans or adjustable-rate mortgages
- Manufactured housing not permitted
- Mortgage insurance is required
- Minimum 620 FICO score
- Pre-purchase home buyer counseling is not required
- Must be underwritten through DU
- Available now

Eligibility requirements for Freddie Mac's Home Possible Advantage

- Available for low- and moderate-income borrowers
- Both first-time buyers and other borrowers with limited down payment savings can qualify
- First-time home buyers must participate in homeowner education program
- Maximum loan-to-value ratio 97%
- Loan options include 15, 20, and 30-year fixed mortgages

- Can be used to purchase a single-unit, primary residence
- Minimum 620 FICO score
- Manufactured housing not permitted
- Income limits vary by area (no limit in underserved areas)
- Lender-paid mortgage insurance permitted
- No reserves required
- Available March 23rd, 2015

U.S Housing and Urban Development (HUD)

In early January, 2015, HUD announced the Federal Housing Administration (FHA) will reduce the annual premiums new borrowers pay by 0.5 percentage point from 1.35% to 0.85%. This change is projected to save more than two million FHA homeowners an average of $900 annually and spur 250,000 new homebuyers to purchase their first home over the next three years.

During the housing crisis FHA increased its premium prices to stabilize the health of its Mutual Mortgage Insurance Fund. The reduction announced is an effort to expand access to mortgage credit for families and is expected to lower the cost of housing for the approximately 800,000 households who use FHA annually. The new annual premiums took effect in late January.

FHA Loans

An FHA loan is a mortgage loan that is insured by the FHA. Essentially, the federal government insures loans for FHA-approved lenders in order to reduce their risk of loss if a borrower defaults on their mortgage payments.

The FHA program was created in response to the rash of foreclosures and defaults that happened in the 1930s; to provide mortgage lenders with adequate insurance; and to help stimulate the housing market by making loans accessible and affordable. FHA loans are very popular, especially with first-time home buyers.

Eligibility requirements for a FHA loan.

- Must have a steady employment history or worked for the same employer for the past two years.
- Must have a valid Social Security number, lawful residency in the U.S. and be of legal age to sign a mortgage in the state purchasing.
- Must make a minimum down payment of 3.5%. The money can be gifted by a family member.
- New FHA loans are only available for primary residence occupancy.
- Must have a property appraisal from a FHA-approved appraiser.
- The front-end ratio (mortgage payment plus HOA fees, property taxes, mortgage insurance, home insurance) needs to be less than 31% of gross income, typically. Buyers may be able to get approved with as high a percentage as 46.99%. The lender will be required to provide justification as to why the lender believes the

mortgage presents an acceptable risk. The lender must include any compensating factors used for loan approval.

- The back-end ratio (mortgage plus all your monthly debt, i.e., credit card payment, car payment, student loans, etc.) needs to be less than 43% of your gross income, typically. Buyers may be able to get approved with as high a percentage as 56.99%. The lender will be required to provide justification as to why they believe the mortgage presents an acceptable risk. The lender must include any compensating factors used for loan approval.
- Minimum credit score of 580 for maximum financing with a minimum down payment of 3.5%.
- Minimum credit score of 500-579 for maximum LTV of 90% with a minimum down payment of 10%. FHA-qualified lenders will use a case-by-case basis to determine an applicants' credit worthiness.
- Typically the buyer must be two years out of bankruptcy and have re-established good credit. Exceptions can be made if the buyer is out of bankruptcy for more than one year if there were extenuating circumstances beyond the control that caused the bankruptcy.
- Typically the buyer must be three years out of foreclosure and have re-established good credit. Exceptions can be made if there were extenuating circumstances and credits improved.
- There are maximum mortgage limits for FHA loans that vary by state and county. In certain counties, you may be able to get financing for a loan size up to $729,750 with a 3.5% down payment. Conventional financing for loans that can be bought by Fannie Mae or Freddie Mac are currently at $625,000.

Veteran Affairs (VA) Loans

Designed to help active duty military and veterans qualify for homeownership, VA Home Loans are guaranteed by the U.S. Department of Veteran Affairs and feature easy home financing options. Because VA loans are government insured, they offer veterans and military personnel lower interest rates and better terms than conventional mortgages. With a government insured VA mortgage, veterans and military personnel may secure a home purchase loan with no down payment and no monthly mortgage insurance premiums. VA Home Loans are popular for first-time mortgages and for buyers with less-than-perfect credit.

Benefits to a VA Home Loan include:

- No down payment required
- Negotiable interest rates
- Adjustable & fixed rate mortgage options
- No monthly mortgage insurance premiums
- No prepayment penalty
- VA assistance to borrowers due to financial difficulty
- Ability to finance the VA funding fee
- Reduced funding fees with a down payment of at least 5% and exemption for veterans receiving VA compensation

Alternative Homeownership Models

There are a variety of alternative homeownership models in California. Some of these methods involve nontraditional ownership models, while others involve nontraditional methods of financing. Below are just a few examples.

Community Land Trusts (CLT)

The CLT model is a mechanism for maintaining and expanding the stock of affordable housing. CLTs, which are community-based and governed by a non-profit board, retain ownership of the land and transfer ownership of the improvements to rental housing developers or income-eligible homebuyers. In the homeownership context, homeowners own the structure but not the underlying land, which they lease via a long-term ground lease. This model promotes affordable homeownership by reducing the cost of the home and ensuring long-term affordability through land covenants.

Lease-to-Own

In lease-to-own real property transactions, the potential homeowner initially lives in the property as a renter, and pays towards purchasing the property within a specific period of time. While lease-to-own contracts vary, they can be used as a mechanism to assist first-time homebuyers. For example, Visionary Home Builders in Stockton, a non-profit lender and developer, offers a lease-to-own program for eligible applicants that do not currently own a home and with an income that does not exceed 80% of the local AMI. As part of the contract, participants develop a plan that allows them to live in their future home for three to five years as they repair their credit, save for a down payment, and plan a household budget that will help sustain long-term homeownership. At the end of the program, participants should be in the financial position to purchase the home. Achieving and promoting financial stability is a central component of the program, and participants are required to participate in extensive financial education.

Community Lending

Community lending involves working with homebuyers who have limited access to down payment funds and who can only afford properties with deed restrictions not found in a traditional real estate transaction. Many mission-based community lending institutions are 501(c)(3) non-profits, while others are for-profit. These lenders often work with multiple layers of financing and have expertise in deed restrictions that help maintain long-term affordability. In addition to financing, these organizations may provide other community-based services, such as financial counseling and foreclosure prevention.

Conclusion

While some remain pessimistic as to what the future holds in the homeownership realm, many remain optimistic. As home values continue to rise after the housing bust, it is timely to identify programs available to first-time homebuyers and explore the shifting economic realities of becoming a homeowner. Only then can we explore possible solutions to sustainably increase our record low homeownership rate.

Small Dollar Consumer Lending in California
January 11th, 2015
2:00pm
Rm: 444

A little over 55% of Californians have subprime credit, meaning they have credit scores below 700.[20] The Consumer Financial Protection Bureau (CFPB) has found that due to no credit files or very thin credit files one in five Americans have no traditional credit score. Couple these factors together and you have a large group of consumers that may have difficulty in getting a personal loan at a bank or credit union or attaining a low interest credit card. This is not to say that everyone in these categories will have the same level of difficulty or need. Some consumers will not need to borrow money, or may have access to credit cards though only 27% of consumers that use small-dollar credit have a credit card, compared to 61% of consumers who do not use small dollar credit.[21] In other surveys, 29% (majority of those surveyed) of payday loan borrowers believe, often correctly that they would not qualify for a loan from a bank or a credit card.[22] Overall American consumers spent $138 billion in fees and in interest across 26 financial products in 2014 with overdraft representing the single largest revenue category of $23.4 billion.[23]

The Banking & Finance Committee has reviewed numerous proposals over the last decade concerning small dollar credit. At times, success has been achieved with the creation of innovative new programs such as the Pilot Program for Increased Access to Responsible Small Dollar Loans. Though, most of the time spent examining the small dollar market is down to a fundamental disagreement between industry participants on one side and consumer organizations on the other. The debate can best be summarized, though somewhat over simplified, to this: Either the underlying economic conditions of the borrower of small dollar credit creates further financial stress that can lead to repeat usage of a specific product such as payday loans, or that the products themselves are designed in such a way that they create a cycle of debt.

This background paper and the hearing itself are designed to provide an overview of the small dollar lending market in California and the pending CFPB proposals which could radically alter the way small dollar credit is offered in California and nationwide.

Deferred Deposit Transaction Law:

A payday loan, known more formally in California as a deferred deposit transaction is a short-term loan in which a borrower writes a post-dated, personal check to a lender for a specified amount, that is capped by state law. The payday lender advances the borrower the amount on the check, less the fee, which is also capped by law. The payday lender does not cash the check at the time the loan is made. Both parties are aware that the borrower lacks sufficient funds to cover the check when 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 payday lender in cash on the loan's due date, and having the lender return the original check to the borrower, without cashing it.

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[20] Corporations for Enterprise Development (CFED), Asset and Opportunity Scorecard, http://scorecard.assetsandopportunity.org/latest/state/ca

[21] Rob Levy and Joshua Sledge. A complex Portrait: An Examination of Small-Dollar Credit Consumers. Center for Financial Services Innovation. August 2012

[22] Consumers and Mobile Finance Services 2014. Federal Reserve Board, March 2014. Pg 9

[23] 2014 Underserved Market Size, Center for Financial Services Innovation, CORE Innovation Capitol, Morgan Stanley. http://www.cfsinnovation.com/CMSPages/GetFile.aspx?guid=ac5235a9-a42a-434c-a26a-66a1b148b712

Under the California's payday loan law, any payday lender who makes a payday loan must be licensed. Each licensee may defer the deposit of a customer's personal check for up to 31 days. The face amount of the check presented by a borrower may not exceed $300, and the fee charged by the licensee may not exceed 15% of the face amount of the check ($45 on a $300 check). This statutorily capped fee must be expressed to borrowers in the form of an Annual Percentage Rate (APR). Given the short-term nature of payday loans (average is 17 days) the average APR is 411%. However, while the APR is high on a short-term product, the dollar costs of the fee cannot exceed 15% of the face amount of the check.

Licensees may charge one non-sufficient funds fee, capped at $15, for checks that are returned by a customer's financial institution. In addition, licensees may not directly or indirectly charge any additional fees in conjunction with a payday loan. Licensees may not enter into a payday loan with a customer who already has a payday loan outstanding and may not allow a customer to use one loan to pay off another. Licensees are also forbidden from accepting any collateral for a payday loan or making any payday loan contingent on the purchase of any goods or services. Each payday loan must be made pursuant to a written agreement. Licensees must clearly post their fees and charges at their business locations.

In the early 1990s, check cashers operated in what could only be termed as a legal gray area as they cashed checks from consumers for a fee (ranging from 10-20%) in which the check might be deposited immediately or held for 14 days. The reasoning behind this practice was the belief that sections of the California Commercial Code concerning the use of checks was the governing body of law for these transactions. These transactions did not involve loan agreements or loan disclosures and the fees were generally the same regardless of the length of time the check was held by the check casher. However, subsequent discussions and opinions led to the creation of clear statutory authority for offering payday loans via SB 1959, (Calderon, Chapter 682, Statutes of 1996). SB 1959 permitted check cashers to defer deposit on payday loans made by the check casher. These transactions were originally regulated by the State Department of Justice. SB 898 (Perata, Chapter 777, Statutes of 2002), shifted the responsibility for administering payday lending from the California Department of Justice to the Department of Corporations (DOC) now known as Department of Business Oversight (DBO).

The debate over the appropriateness of the payday loan product has been the subject of numerous bills appearing before this legislature since the first statute authorizing the product. Consumer organizations highlight that payday loans are a "debt trap" meaning that the borrower gets stuck in a cycle of debt leading to further deficits in personal income. For example, if the borrower doesn't have $300 today for expenses then will the borrower have the extra money after paying their regular bills, to pay back the loan in two weeks when the loan comes due? In many cases, the borrower simply takes out additional loans, back-to-back, in an attempt to make up the income deficit. As will be discussed later, many payday borrowers take out numerous loans throughout the year. The other side of this debate is that payday loans are a necessary product for consumers to fill short term needs and pay emergency expenses. Additionally, some argue that it is a product of last resort for borrowers as they may have exhausted other options, or they may not have had options to begin with.

California Finance Lenders Law (CFLL)

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 was enacted by the California legislature effective on July 1, 1995 and consolidated and replaced the Personal Property Brokers Law, the Consumer Finance Lenders Law and the Commercial Finance Lenders Law which were previously applicable to personal property brokers, consumer finance lenders, and commercial finance lenders.

The CFLL provides for varying rate structures depending on the amount of money borrowed. The consumer lending structure of the CFLL involves installment loans both secured (car title lending) and unsecured loans. The allowed APRs on these consumer loans vary from 12% to over 100%. The existing tiered structure of the CFLL has its own Rubicon which after it is crossed anything goes. Specifically, this is the $2500 and above loan tier where no interest restrictions exist and the market is left to create its own pricing. As discussed later in this document the rate structure below $2,500 historically has not had wider market usage as many argue that the rates on short term installment loans are so low that most lenders cannot be profitable on those types of loans. A response to this problem was the creation of a pilot program that allowed for some increases in rates and fees in the hopes of jump starting more lender participation in the small dollar loan markets. This program is discussed later in this document.

The $2,500 line in the lending sand dates to 1985 when a bill to lower the ceiling on regulated loans to $2,500 which increased the number of loans with unlimited rates. Supporters said they thought it would open up competition and eventually push rates down. The limit had been lowered to $5,000 from $10,000 in 1983.

The bill's author, the late Sen. Rose Ann Vuich wrote to then Governor Deukmegian in support of the bill “Rates above $5,000 are now set competitively in the marketplace and are generally below the former statutory rate ceilings,” and the current bill “is expected to lead similarly to lower rates for loans in the $2,500 to $5,000 bracket.”

The Department of Corporations at the time argued in favor of the 1985 bill, stating “rate regulation provides very little consumer protection and may even work against consumers since lenders tend to lend money at the maximum allowable rate irrespective of the credit worthiness of the borrower.”

Who makes use of the costly products? The Federal Deposit Insurance Corporation (FDIC) estimates (National Survey of Unbanked and Under-banked Households) estimate that one third of households nationally; utilize alternative credit products, which would include loans offered under the CFLL. The Center For Economic and Policy Research has concluded via their study, "*Small-Dollar Lending: Is There a Responsible Path Forward*" that "it is reasonable to infer from the very large size of the current market for ultra-high-cost credit…that the unmet demand for high-quality small-dollar loans is very large. Presumably, all of those who currently obtain ultra-high-cost loans would, other things being equal, prefer to obtain much lower-cost affordable loans." In 2010, the Center for Financial Services Innovation (CFSI) reviewed the subject of small dollar loans, including obstacles to greater access and growing alternative approaches. CFSI states that installment loans are costly to provide due to the operation of physical stores and underwriting expenses. Furthermore, they stated, "One industry representative estimates that achieving breakeven with a $200 loan requires charging borrowers an APR of about 250%. The breakeven APR drops to approximately 145% if the volume of $250 loans reaches 1,000. Larger loans in the amount of $2,500 would require APRs closer to 44%, and the breakeven APR would drop to a projected 35% if 1,000 loans at that amount were made." On the other side of this debate some argue that the high interest rates are not a reflection of actual risk, but an attempt to exploit customers for greater financial gain.

Alternatives

The Legislature and Governor in 2010 enacted the Affordable Credit Building Opportunities Pilot Program (ACBO), placing it under the CFLL. The goal was to increase consumers' access to capital by encouraging development of a more robust small dollar loan market in California. The ACBO – established by SB 1146 (Florez) – took effect January 1, 2011. Its provisions applied to consumer loans of $250 to $2,499. To incentivize lenders' participation, the ACBO allowed them to charge borrowers marginally higher interest rates, and larger origination and delinquency fees than those permitted for CFLL consumer loans of that size made outside the program.

A low lender participation rate led to ACBO's demise. It was replaced by the Pilot Program for Increased Access to Responsible Small Dollars Loans, created in 2013 under SB 318 (Hill). The Pilot –*Financial Code section 22365 et seq.* – took effect January 1, 2014. It will remain in effect until January 1, 2018, unless extended by the Legislature and Governor.

Pilot Performance.

DBO recently released a report, *Report of Activity Under Small Dollar Loan Programs,* on the performance of the ACBO and the Pilot covering January 1, 2011 to December 31, 2014. The data presented in the report includes loans arranged without a finder as finder activity was very limited and not reported until 2014. The following are highlights from the report:

- Loan applications – Borrower applications increased by 58.5 percent over the period, from 207,092 in 2011 to 328,198 in 2014. The loan approval rate increased from 39 percent in 2011 to 50 percent in 2014.

- Aggregate principal – The annual total principal of loans made increased by 83.8 percent over the period, from $97.9 million in 2011 to $179.9 million in 2014.

- Dollar amounts – Loans made in the $300-$499 range fell by 42.3 percent over the period, from 1,518 in 2011 to 876 in 2014. Loans made in the highest range, from $1,500 to $2,499, increased by 106 percent, from 21,349 to 43,975.

- Interest rates – Of the 6,560 loans made in the $300-$499 range over the period, 73.9 percent carried an APR of 40 percent to 49.99 percent. In the $500-$999 range, 43.4 percent carried APRs of 40 percent to 49.99 percent, while 25.2 percent had APRs of 35 percent to 39.99 percent. In the $1,500-$2,499 range, the APR distribution was more even. In that category, 42.8 percent of the loans had APRs of 35 percent to 39.99 percent, while 19.6 percent had APRs of 30 percent to 39.99 percent, 18.2 percent had APRs of 40 percent to 49.99 percent, and 15.6 percent had APRs of 25 percent to 29.99 percent.

- Delinquencies – Of the 164,300 loans made in 2014, 22.5 percent were delinquent for seven days to 29 days, 7.3 percent were delinquent for 30 days to 59 days, and 3.9 percent were delinquent for 60 days or more.

- Multiple loans – The number of borrowers who took out more than one loan jumped dramatically from 2011 to 2012. Since then, however, the upward trajectory has been less steep. The number went from 2,189 in 2011 to 10,804 in 2012. From 2012 through 2014, the number rose by 21.6 percent, to 13,136. Of the 13,136 multiple-loan borrowers in 2014, 12,999 took out two loans.

- Credit scores – The share of multiple-loan borrowers who obtained higher credit scores on subsequent loans averaged 61 percent annually over the four-year period. The average size of the increase for those borrowers jumped from 34 points in 2011 to 355 points in 2014.

- Loan term – In 2014, of the 164,300 loans made, 50.9 percent were for 360 days or more. The ratios for other terms: 120 days to 179 days, essentially 0 percent (only two loans); 180 days to 269 days, 20.2 percent; and 270 days to 359 days, 28.8 percent.

- Borrower income – Of the 486,287 loans from 2011-2014, 18.4 percent were made in low-income neighborhoods. The ratios for other neighborhood income levels: moderate-income, 45.4 percent; middle-income, 21.1 percent; and upper-income, 4.4 percent. The annual low-income ratio increased from 16.6 percent in 2011 to 19.5 percent in 2014.

- Loan purpose – Of the 164,300 loans made in 2014, borrowers took out 45 percent (74,026) to build or repair credit. Ratios for other purposes: medical or other emergency, 18.4 percent; pay bills, 12.7 percent; consolidate debt, 5.7 percent; non-vehicle purchase, 5.3 percent; vehicle purchase, 2.7 percent; vehicle repair, 2.6 percent; other, 6.4 percent.

Internet Lending

Many licensed payday lenders that have storefront operations also offer payday loans via the internet in compliance and conjunction with their state licenses in accordance with state law. However, unregulated online lending has grown in recent years. Pew research predicts that by

2016 internet loans will account for 60% of payday loans almost double from 2012. August 16, 2012 the LA Times reported, *California Warns of Online Payday Lending Risk,* that the Department of Corporations, known now as DBO, had issued a consumer alert concerning the dangers of online lending, as well as sanctioned nine payday lenders for unlicensed activity. On February 23, 2013, the New York Times reported, *Major Banks Aid in Payday Loans Banned by States,* that a growing number of payday lenders had setup online operations to avoid rate caps in states that have banned payday lending. The article pointed out that for an online payday loan the borrower gives the lender their account and routing number to set up automatic repayment of the loan via their account. These authorizations can lead to numerous overdraft charges as online payday lenders repeatedly ding the consumer's account for the outstanding loan repayment. In some cases, these transactions have occurred even after the loan was paid off. In one case highlighted in the article, a consumer with six outstanding payday loans attempted to close their bank account to stop any future withdrawals. The account was not closed by the bank and the consumer racked up $1,523 in insufficient funds fees, extended overdraft and service fees. The article further placed responsibility on the banks for allowing automatic withdrawals by illegal payday lenders and for not quickly honoring consumer's requests to end these withdrawals in a timely manner.

Restricting unregulated payday lending is difficult as many payday lenders may operate offshore in other countries or use tribal sovereignty to avoid state enforcement. Furthermore, borrowers may not be aware that an illegal payday loan (loan made by unlicensed lender) is unenforceable. These unregulated payday lenders typically will not follow consumer protection laws, fair debt collection laws, and in some cases may abuse the court process to intimidate borrowers into paying their loans. While storefront payday lenders may be limited by geographic location, internet payday lenders (both legal and illegal) are available by the thousands online and those that are unlicensed are not constrained by fee caps. This lack of regulation may, unfortunately, make them an attractive option for borrowers seeking to borrow beyond the California limit of $300.

Research on the impact of storefront payday lending restrictions and a potential growth in online lending reveal that consumers would not necessarily choose the online lending route if storefront payday lenders were eliminated. However, some media reports have highlighted concerns with the rising use of unregulated online payday. The Portland Business Journal reported on February 11, 2009, *Borrowers Flock to Online Payday Lenders,* that Oregon laws effectively banned 80% of the state's storefront payday lending businesses and forced borrowers to turn to unregulated online payday lenders. As with the previously mentioned articles, online borrowers in Oregon faced harassing and illegal debt collection tactics, extremely high fees and interest rates, and deceptive marketing ads. The Portland Business Journal article did not reveal actual data on the amount of online lending before or after Oregon's heavy restrictions on storefront lending. This lack of data is a typical problem in researching this issue.

Online payday lending largely functions through the use of third party online finders or referral services. Many of the online loan portals a consumer may find on the internet may be finders and not actual payday lenders. These finders take the borrower's information and then send it out for bids from payday lenders on what they will pay to the finder to lend to the particular borrower. Once a lender is matched with a borrower, the borrower is forwarded to that specific lender's loan website. This process happens behind the scene in only a few minutes. This system of finders, however, fuels unregulated online lending. If a borrower from California goes through one of these services (often the borrower will not know whether the site they are visiting is a lender or finder) the third party service does not determine whether the payday lenders who bid for the loan are licensed in California, or for that matter, licensed anywhere. Typically the factors that determine whether the loan is funded is the referral fee that the lender is willing to pay to the finder, and if the borrower meets that lender's risk profile.

Some of the risk of online lending that occurs outside of California's laws and restrictions has been mitigated through actions of DBO. On April 7th, 2015 DBO announced[24] efforts to work with major Internet search engines (Google, Bing, Yahoo, Ask Jeeves[25]) to block unlicensed payday lender ads. Under these efforts, DBO issues cease and desist orders against the unlicensed lender and then forwards copies of those orders to the search engines so they can take action to block the lender from search results.

Marketplace Lending or Peer to Peer:

Marketplace lending cuts a broad swath across a diverse set of credit needs from installment loans, payday loans, student loans, real estate finance, merchant advance, small business loans and even purchase finance. Marketplace lenders use computer-driven systems to evaluate borrowers and approve them in minutes or hours using the power of big data to determine credit risk, often using other credit indicators outside of a traditional FICO score. Instead, marketplace lenders evaluate current job position and potential for promotion, as well as a borrower's higher education achievements to see if they are a sound candidate for a personal loan. Conventional credit requirements including monthly income versus expenses may also be evaluated to determine eligibility, but these are often combined with other, less tangible borrower attributes. Combining these factors paints a more comprehensive picture of a borrower, allowing the marketplace lender the ability to rate the overall risk of a loan on more than a simple financial analysis of an individual.

These companies started out making unsecured personal loans, mostly to pay off credit-card debt, but have since branched out into bigger products such as small-business loans and mortgages. Loan amounts can vary from a few thousand dollars to a hundred thousand dollars.

The regulatory landscape is different than typical lenders. Lending Club, for instance, doesn't originate loans, so it isn't subject to bank regulation however they are licensed as a CFL. Instead, it partners with Salt Lake City-based WebBank, which originates Lending Club's loans and sells them quickly to investors like hedge funds, or to other banks. Prosper, another large marketplace

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[24] http://dbo.ca.gov/Press/press_releases/2015/Search_Engine_initiative_04-07-15.pdf

[25] HA! Ask Jeeves no longer exists and has morphed into Ask.com. If you read this note that means you have read further than most.

lender, obtained several non-bank state licenses across the nation including the CFL license. With differing laws in each state this model became a compliance burden so Prosper attempted to get an industrial loan charter so they could lend with uniform terms across all states. This effort was unsuccessful so Prosper partnered with WebBank just as Lending Club did. Prosper and WebBank have adopted an interest rate cap of 36% for their loans even though under their arrangement they are not restricted on what interest rate they may charge.

The key difference between marketplace lenders and conventional lenders (Banks, credit unions, CFL installment lenders) is how loans are funded. Instead of dipping into their own coffers to finance a new personal loan, marketplace lenders list a newly accepted loan on their website for investors to fund. Accredited investors and institutional investors have the ability to fund all or a portion of a loan listed on a lender's site, and those investors bear the risk of the borrower defaulting on payments. This unique relationship creates an environment where those who need funding are put in direct contact with those who have the ability to give it, with the lender simply acting as the online conduit necessary to complete the transaction in a transparent, safe manner.

Small dollar lending laws in California:

PRODUCT	TRANSACTION VOLUME	DOLLAR VOLUME	STATUTORY GUIDELINES
Deferred Deposit Transaction (Payday Loans)[26]	12,407,422 total loans to 1,818,524 individual customers	$3,376,447,239	The amount of the consumer's personal check cannot exceed $300. The lender cannot charge a fee that is higher than 15 percent of the check amount. So, for example, a borrower who gives the lender a check for $300 will take home only $255 if the lender charges the maximum fee of 15 percent. The term of a payday loan cannot last longer than 31 days.
Finance Lenders Law Below $2500[27]	345,796 loans[28]	$243 million	• First $225, 2.5% per month (30% annual rate) • Over $225, less than $900, 2.0% per month (24% annual rate) • Over $900, less than $1650, 1.5% (18% annual rate) • Over $1,650, less than $2,500, 1.0% per month (12% annual rate) • In addition to interest lenders are allowed to charge borrowers the lessor of 5% of the loan amount or $50 as an Administrative fee. • Lenders may also sell credit insurance.
Finance Lenders Law $2500 and above[29]	348,028 loans	$1,030,263,000	No interest rate cap.

[26] Data from 2014 DBO Annual Report: Operation of Deferred Deposit Originators Licensed under the California Deferred Deposit Transaction Law

[27] Data from 2014 DBO Annual Report: Operation of Finance Companies under the California Finance Lenders Law. Number reported here includes only unsecured loans. CFL allows other types of lending (e.g. commercial, real property, and auto-lending)

[28] 80% of volume is from two companies, Oportun and Adir Financial.

[29] DBO Annual report on California Finance Lenders.

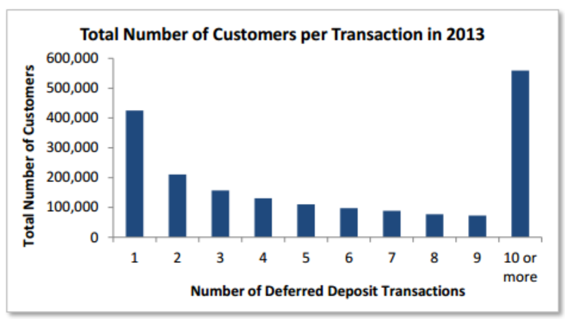
Car Title (licensed under CFL)[30]	105,259 loans	$381,878,000	All but 1,114 car title loans occurred in amounts at and above $2,500 and thus were not subject to interest rate limitations.
Pilot Program[31]	164,300 loans	$179,942,616	• Up to $1,000-lessor of 36% or Prime rate plus 32.75% • Over $1,000, less than $2,500-lessor of 35% of Prime rate plus 28.75 • Lenders may charge administrative fee of the lessor of 7% or $90 on the first loan to a borrower, the lessor of 6% or $70 for subsequent loans.

A vast majority (80%) of the volume of CFL lending below $2500 is from two companies, Oportun and Adir Financial. Adir provides product financing for Southern California based retailer Curacao and Oportun is also the top lender, in volume under the pilot program.

Payday lending is a $3 billion business with over 12 million transactions and the most used small dollar loan product among the options currently available. In 2014 DBO released a payday loan industry survey covering 273 licenses or about 78%.[32] The survey revealed large majorities of customers taking 10 or more payday loans (559,535) in a year or 1 loan in a year (425,464). The chart below has a breakdown of loans per customer according to the 2014 survey. The 2015 survey did not include similar information.

Deferred Deposit Transaction Volumes per Customer

Questions one through ten of the Survey asked deferred deposit transaction originators (payday lenders) to report the number of customers who have obtained a specified number of transactions during 2013. The table below and graph to the right provide the aggregated response data for each question.



Source: Survey questions 1 through 10.

Question #	1	2	3	4	5	6	7	8	9	10
Question text	Number of customers who obtained 1 deferred transaction	Number of customers who obtained 2 deferred transactions	Number of customers who obtained 3 deferred transactions	Number of customers who obtained 4 deferred transactions	Number of customers who obtained 5 deferred transactions	Number of customers who obtained 6 deferred transactions	Number of customers who obtained 7 deferred transaction	Number of customers who obtained 8 deferred transaction	Number of customers who obtained 9 deferred transaction	Number of customers who obtained 10 or more deferred transactions
2013 Totals	425,464	210,852	156,881	130,772	110,339	97,495	88,447	76,809	72,413	559,535

Active Military Customers

- In 2013 less than one percent of reporting licensees indicated that they have customers who are in active military service. Of this share of payday lender licensees, the total number of customers was 5,663, with 5,717 unique transactions amounting to $1,375,448. *(Source: Survey questions 38 through 41.)*

[30] Ibid.

[31] Pilot Program for Increased Access to Responsible Small Dollar Loans. Data from DBO *Report of Activity Under Small Dollar Loan Pilot Programs*, January 1, 2011 through December 31, 2014.

[32] *2014 California Deferred Deposit Transaction law Industry Survey*. http://www.dbo.ca.gov/Licensees/Payday_Lenders/pdfs/2014_CDDTL_Industry_Survey_Summary_Report_Letter.pdf

Sample Small Dollar Loans Offered in California[33]

LENDER	TERM[34]	Statutory authority	LOAN AMOUNT	PAYMENTS	PAYMENT AMOUNT	FINANCE CHARGE	TOTAL REPAYMENT	APR
Check 'N Go	14 d	DDTL	$255	1	$300	$45	$300	460%
Rise Lending	16 m	CFLL	$2,600	32	$241	$5,126	$7,726	224%
Oportun	13 m	CFLL Pilot	$1,000[35]	27	$49	$292	$1,292	49.3%
CashCall	47 m	CFLL	$2,600	47	$294	$11,239	$13,840	135%
SpeedyCash	47 m	CFLL	$2,600	91	$137	$9,864	$12,464	132%
Lending Club	36 m	CFLL[36]	$6,000	36	$185.24	$788.64[37]	$6668.64	8.36%
SpotLoan	3 m	Tribal loan	$800	6	$212	$472	$1272	390%

<u>Research Findings Concerning Small Dollar Credit.</u>

- Only 27% of small-dollar credit users have a credit card, compared to 61% of non-small dollar credit consumers. (Levy & Sledge).

- Less than half of payday customers have savings or other types of liquid credit. (Elliehausen).

- Top three uses for small dollar credit include utility bills (36%), general living expenses (34%) and rent (18%). (Levy & Sledge).

- 54% of payday borrowers have a bank credit card compared to 74.5% of the general population. (Elliehausen).

- Most payday borrowers are aware of the finance charge but not the APR. (Elliehausen).

- Nearly 40% of payday borrowers have reported not paying back their original loan when it first came due (Levy & Sledge).

- 70% of installment loans are fully paid off and most borrowers do not keep their loans until maturity as most are paid off or charged off before the maturity date. (Beals & Goel).

- 60% of payday borrowers are able to accurately predict when they will finally repay their loans meaning that borrowers know before they even borrow that they will need the loans for longer than two weeks. (Mann).

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[33] Information on loan terms and pricing gathered from information on licensees websites and other publically available sources.
[34] M=Months D=Days
[35] Loan amount, terms and conditions in this example are based on a typical loan offered to a new customer.
[36] Lending Club and several other marketplace lenders are licensed as CFLL lenders but also have partnerships with specific financial institutions. This is just one possible type of marketplace loan. Marketplace loans can vary widely on loan amounts, fees and interest rates.
[37] Total finance charge includes interest paid over length of payments and origination fee which is held back from the loan proceeds by the lender.

- The use of payday loan funds is consistent across multiple studies of the issue with two-thirds of borrowers using the funds for recurring expenses (rent, utilities, groceries, etc.), with around 10% using payday loans for emergencies. (Mann).

- Payment-to-income ratio may be a poor metric for predicting whether a loan will be paid off or not. (Beals & Goel)

- Lack of knowledge concerning payday loan alternatives may assist with a perception that options don't exist. (Edmiston).

- Two factors most heavily associated repeat loan usage are 1) ratio of loan size to income, and 2) when the need for credit came from a consistent shortfall in income relative to expenses. (Levy & Sledge).

- Payday borrowers may be option limited due to the constraints of their credit ratings. (Edmiston).

- In reviewing small dollar credit (payday loans are included in this definition) researchers found that the top three loan attributes that mattered most were: quick access to money, ability to qualify, and clear terms. (Levy & Sledge).

- Repeat loan usage has been correlated with the ratio of loan size to income, and that the need for credit came from a consistent shortfall of income relative to expenses. (Levy & Sledge).

- Operating costs for payday lenders are high relative to the size of the payday loan and these high costs offset much of the revenue generated from the loan. (Elliehausen).

- Research on states that have banned payday lending concludes a range of impacts, from increased use of unregulated online lending to other negative credit effects. Other studies and surveys have found consumer satisfaction that the product is gone, or a belief that the dangers of the product outweigh the benefits. Media reports suggest that online lending has increased in states with a ban, while the Pew research disputes this.

- The Pew Charitable Trusts, provides the following:

    - Twelve million American adults use payday loans annually. Nationally, on average, a borrower takes out eight loans of $375 each per year and spends $520 on interest.

    - Most borrowers use payday loans to cover ordinary living expenses over the course of months, not unexpected emergencies over the course of weeks. The average borrower is indebted about five months of the year.

    - If faced with a cash shortfall and payday loans were unavailable, 81% of borrowers say they would cut back on expenses. Many also would delay paying some bills, rely on friends and family, or sell personal possessions.

- In states that enact strong legal protections, the result is a large net decrease in payday loan usage; borrowers are not driven to seek payday loans online or from other sources. Fifty-eight percent of payday loan borrowers have trouble meeting monthly expenses at least half the time.

- The choice to use payday loans is largely driven by unrealistic expectations and by desperation. A majority of borrowers say payday loans take advantage of them, and a majority also say they provide relief. The appreciation for urgently needed cash and friendly service conflicts with borrowers' feelings of dismay about high costs and frustration with lengthy indebtedness.

- By almost a 3-to-1 margin, borrowers favor more regulation of payday loans. In addition, two out of three borrowers say there should be changes to how payday loans work. Despite these concerns, a majority would use the loans again. In a state where payday storefronts recently stopped operating, former borrowers are relieved that payday loans are gone and have not sought them elsewhere.

- 55% of borrowers surveyed believe that payday loans take advantage of borrowers, while 48% say the loans help more than hurt, with 8% reporting that the loans both help and hurt. Furthermore, 56% say the loans relieve stress and anxiety versus causing it.

- Six reasons people use payday loans:

  - Desperation, as more than a third of borrower's report that a situation in which they were so desperate they would accept a loan on any terms offered.

  - Perception that payday loans do not cause ongoing debt.

  - Reliance on accurate information provided by the payday lender that the product is a two week loan.

  - Focus on fee, rather than how a lump sum repayment will affect their budget.

  - Trust that by some bank deposit borrowers that bank payday loans are safer than non-bank payday loans.

  - Temptation as some borrowers consider them too easy to obtain.

Consumer Financial Protection Bureau (CFPB) Proposal:

In March of 2015 the CFPB released a framework to regulate short-term loan products nationwide. In articulating the basis for the proposed rule, CFPB Director Richard Cordray said:

> *Today we are taking an important step toward ending the debt traps that plague millions of consumers across the country. Too many short-term and longer-term loans are made based on a lender's ability to collect and not on a borrower's ability to repay. The proposals we are considering would require lenders to take steps to make sure consumers*

can pay back their loans. These common sense protections are aimed at ensuring that consumers have access to credit that helps, not harms them.

The final rules on these loan products are set to be released in stages. According to the latest information available, the first round of rules covering payday loans and deposit advance products are set to be released sometime during February of 2016. The rules for installment loans and vehicle title loans are set for release September of 2016.

The proposal is divided into provisions for "short-term loans" and "long-term loans" with the rules for those transactions divided between "debt-trap prevention" and "debt-trap protection."

The debt-trap prevention approach encompassed in the proposal would attempt to prevent so called "debt-traps" by requiring lenders to take into account certain factors during the underwriting or credit scoring phase, such as verifying the applicant's income, other major financial obligations, and borrowing history.

Under the debt-trap protection approach, lenders would be required to take certain steps to ensure that a consumer can afford to repay their debt, such as limiting the number of loans a borrower can take out in a row and over a certain period of time.

Short-Term Credit:

The portions of the proposal applicable to "short-term credit" apply to loans of 45 days or less and includes payday loans and other loans that would fall into this time frame.

Short-term lenders who choose to comply with the debt-trap prevention requirements would need to comply with the following requirements:

1) Confirm that an applicant can repay the loan when due without defaulting or re-borrowing before approving the applicant for credit.

2) Adhere to a 60-day cooling off period between loans.

3) Confirm the applicant does not have any outstanding covered loans with any lender.

4) If the loan is consumer's 2nd or 3rd loan within a two-month window, document that there has been some "change in circumstances" in the borrower's financial situation (e.g., an increase in income) so as to enable the borrower to repay the new loan without re-borrowing.

5) If three loans are taken out within a short period of time, adhere to a 60-day cooling period. In other words, lenders would be prohibited from extending credit to that borrower within 60 days after the borrower pays off a third loan within a short, still undefined, period of time.

Lenders choosing to follow the debt-trap protection approach would be required to comply with the following:

1) Loan amount limited to $500.

2) Loan term limited to 45 days.

3) May only collect one finance charge.

4) Consumer's vehicle may not be used as collateral.

5) Confirm the applicant would not be in debt more than 90 days on covered short-term loans in any 12-month period.

6) Confirm the applicant does not have any other outstanding covered loans with any lender.

7) Cap rollovers at two (i.e., three loans total) and adhere to a 60-day cooling off period after the 3rd loan.

8) Only provide 2nd and 3rd consecutive loans if the lender provides an affordable way out of the debt. CFPB has considered two approaches to meet this requirement. The first would require a decrease in principal over the three-loan sequence so that it is repaid in full when the third loan is due. The second would require the lender to offer a no-costs payment plan.

Long-Term Credit:

The long-term credit provisions of the proposal would cover credit products for which:

1) The loan term is more than 45 days;

2) The lender has access to the borrower's bank account or paycheck or a security interest in a vehicle; and

3) The "all-in" APR is more than 36% (including interest, fees, and add-on product charges).

This definition would include certain longer term title loans, high-cost installment loans, and open-end products.

As with short-term lenders, long-term lenders choosing to comply with the debt prevention approach would be required to verify the consumer's income, other major financial obligations, and borrowing history to evaluate the applicant's ability to repay. Lenders would also be required to confirm a consumer is able to repay the loan each time a borrower requests to refinance or re-borrow. For borrowers that have missed a payment, the lender would be prohibited from refinancing the loan into another loan with similar terms unless the lender obtains documentation the borrower's financial circumstances have improved such that the borrower can afford to repay the new loan.

The CFPB is considering two alternatives for the debt trap *protection* approach, both of which would permit lenders to extend credit with a minimum of 45 days a maximum of 6 months. The first approach would require lenders to follow the same protections as "payday alternative loans" offered by the National Credit Union Administration. That is, interest would be capped at 28% and any application fees would be capped at $20. Loan amounts would be restricted to $200-$1,000 with the balance decreasing over the term of the loan. Consumers would only be able to enter into one of these loans if the consumer has no other covered loans at the time and lenders would be prohibited from offering more than two of these loans to a consumer within 6 months (but not more than one at a time).

Under the second approach, monthly loan payments would be limited to no more than 5% of the consumer's gross monthly income. The consumer could not have more than one covered loan at a time and no more than two of such loans in a 12-month period.

Access to Bank Accounts:

The proposals would also place restrictions on lenders accessing borrowers' checking accounts. Small-dollar lenders currently use one or more of several methods to collect payment for a loan:

1) Obtain an authorization to electronically debit a borrower's checking, savings, savings, or prepaid account. This can take the form of an authorization to debit the borrower's account for the full amount of the loan after the maturity date or an authorization to debit the borrower's account multiple times for smaller amounts than the full amount of the loan after the maturity date.

2) Use a remotely created check.

3) Take a post-dated check from the applicant at the time the loan agreement is executed.

The CFPB is currently considering two different proposals to curb these practices. The first would require lenders to notify borrowers three business days before attempting to withdraw funds from the borrower's account and include the following information:

1) The exact amount and date of the upcoming payment attempt;

2) The payment channel through which the attempt will be made;

3) A breakdown of the application of payment amount to principal, interest, and other fees and charges;

4) The loan balance remaining if the payment attempt succeeds;

5) The name, address, and phone number the borrower can use to reach the lender; and

6) For payment attempts via signature check or remotely created check, the check number associated with the payment attempt.

The second proposal being considered would prohibit lenders from making any additional attempts to access a borrower's bank account after two consecutive unsuccessful attempts. A check that is returned from the borrower's bank due to insufficient funds, for instance, would be considered an unsuccessful attempt. The lender would be required to obtain a new authorization from the borrower before initiating any new transactions to withdraw money from the borrower's bank account.

Recordkeeping:

The proposal would require lenders to retain records of compliance for 36 months after the last entry on the loan, including:

1) Documentation of the determination of ability-to-repay;

2) Verification of the consumer's history of covered loans;

3) Documentation regarding the consumer's eligibility for any loan; and

4) History of payment presentments.

The CFPB would also require annual reports for each type of covered loan, including data regarding information such as defaults, reborrowing, and refinancing

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Assembly Banking and Finance Committee

Informational Hearing

Banking the Medical Cannabis Industry

February 29, 2016

2:00 p.m.

State Capitol, Room 4202

Banking Medical Cannabis Businesses (MCBs)

On January 1, 2016, the regulation and oversight of medical marijuana came under the control and guidance of The Medical Marijuana Regulation and Safety Act (MMRSA). MMRSA was the result of a three bill package, AB 243 (Wood), AB 266 (Bonta) and SB 643 (McGuire). These bills govern cultivating, processing, transporting, testing, and distributing medical cannabis to qualified patients. As the discussion around medical marijuana continues in the Legislature the difficulty of "banking" MCBs has become part of the larger dialogue. Medical Marijuana is estimated to be a $2.7 billion industry in California. The lack of banking services creates public safety issues, difficulties in paying employees and only further feeds into stereotypes as participants in the industry must trade envelopes of cash for basic services. It creates revenue and taxation issues for local governments and the state of California as MCBs are unable to make electronic payments for taxes or licensing fees, and instead must transport envelopes or even bags full of cash to the offices of the State Board of Equalization to pay state sales taxes. Some individuals and businesses in this industry are forced to use creative business structures in order to pay fees, taxes, make payroll, and collect payments that could lead to even further risks as they blur the line of what is a legal business formation.

The future regulation of MCBs and access to financial institutions are a vital part of a larger discussion about the conflict between California, which has legal medical marijuana and federal law which classifies marijuana as a controlled substance. Achieving mainstream banking for MCBs is not as straightforward as proposing changes to state law.

Summary of Obstacles

Lack of access to Federal Reserve System (FRS): A financial institution must have access to the FRS to deposit funds and transfer funds electronically. This account is known as a master account and is effectively the bank's bank account. Attempts thus far to establish state chartered financial institutions for MCBs have been unsuccessful due to those institutions not being able to access the FRS.

Deposit insurance: Federally or state chartered financial institutions are required to have deposit insurance. Credit unions may get insurance through the National Credit Union Administration (NCUA) or private insurance. Neither NCUA or private insurers have been willing to insure the nation's first cannabis based credit union in Colorado.

Compliance costs issues: Banking MCBs can create additional compliance costs for institutions as they perform reviews and oversight to comply with the Federal rules and regulations concerning money laundering controls. Financial institutions have also reported the potential need for increased security in branches as large amounts of cash would be deposited.

Racketeer Influenced and Corrupt Organizations (RICO) Act: Activities that could benefit a criminal enterprise would fall under the RICO Act and place financial institutions in danger of violation. A violation could risk forfeiture of an institution's assets or collateral used to secure loans.

Cole memo: On August 29, 2013, James M. Cole, the Deputy Attorney General issued what is now known as the "Cole memo." The Cole memo attempts to clarify how the Department of Justice (DOJ) would use its resources to enforce the Controlled Substances Act (CSA) in states with legalized medical or recreational cannabis. The memo specifies several things that the DOJ would look at in making a determination to enforce the CSA. The Cole memo did not add clarity to the issue of banking MCBs.

Financial Crimes Enforcement Network (FinCEN) Guidance: FinCEN issued guidance in 2014 clarifying the Bank Secrecy Act expectations for MCBs. This guidance requires financial institutions to conduct enhanced due diligence when opening an account for a MCB including a specific filing requirement for suspicious activity reports (SAR) that included new SARs known as Marijuana Limited SAR, Marijuana Priority SAR and Marijuana Termination SAR. This due diligence was also required to be conducted on an ongoing basis and includes the monitoring of public information.

Discussion

An obstacle faced by those operating MCBs in California is the lack of banking services. Businesses ranging from dispensaries to growers all operating within California's legal framework have faced the closure of bank accounts or denial of new accounts. This has led to fees and taxes being paid at government offices with large bags of cash that only raise further suspicion or create security concerns.

On February 14, 2014 the FinCEN issued guidance (FIC-2014-G001) to clarify Bank Secrecy Act compliance expectations for financial institutions seeking to provide services to cannabis-related businesses. Financial institutions and those in the legal cannabis business hoped that the guidance would provide greater clarity and potentially open up more financial institutions for access. Unfortunately, the guidance only added further confusion and did little to eliminate the risk faced by financial institutions.

Banks are required to file SARs when they think that a transaction might have an illegal connection such as drug trafficking. Rather than clarify the existing SAR process for legal cannabis businesses the new guidance outlines three tiers of SARs to use just for cannabis businesses: “cannabis limited,” “cannabis priority,” and “cannabis termination.” In spite of expanding paperwork requirements FinCEN was quoted in the press as saying that these changes would reduce the burden on banks. Almost two years after the issuance of this guidance, financial institutions are still hesitant to open accounts for legal cannabis businesses whether they are in California or other states that have legal medical or recreational cannabis.

The current federal enforcement policy concerning state legalized cannibals activity is contained in a document discussed previously as the Cole memo. This memo provides guidance to federal enforcement authorities giving the status of cannabis as legal for medical or recreational use in several states. The Cole memo illuminates how federal prosecutorial resources will be focused on the issue of cannabis by providing the following enforcement priorities:

1) Preventing the distribution of cannabis to minors;

2) Preventing revenue from the sale of cannabis from going to criminal enterprises, gangs, and cartels;

3) Preventing the diversion of cannabis from states where it is legal under state law in some form to other states;

4) Preventing state-authorized cannabis activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal activity;

5) Preventing violence and the use of firearms in the cultivation and distribution of cannabis;

6) Preventing drugged driving and the exacerbation of other adverse public health consequences associated with cannabis use;

7) Preventing the growing of cannabis on public lands and the attendant public safety and environmental dangers posed by cannabis production on public lands; and

8) Preventing cannabis possession or use on federal property.

This list of priorities would seem to blunt any arguments that the federal government is looking to override the state laws that allow some use of cannabis. Yet the Cole memo also includes the following language left open to broad interpretations.

> *If state enforcement efforts are not sufficiently robust to protect against the harms set forth above, the federal government may seek to challenge the regulatory structure itself in addition to continuing to bring individual enforcement actions, including criminal prosecutions, focused on those harms.*

The FinCEN guidance and the Cole memo do not provide a safe harbor to financial institutions, but rather outline a series of actions that ultimately are not a guarantee that an institution could face sanction. Furthermore, financial institutions face the uncertainty that should federal enforcement of drug laws increase, even with state level marijuana legalization, that they run the risk of having assets seized or frozen, particularly assets that have been used as collateral for loans and lines of credit with financial institutions. Without a change to the status of cannabis as a Schedule I drug at the federal level, businesses legal under state law will continue to operate in a murky area where enforcement of federal law is only as consistent as federal policy, versus statute, wants it to be.

Test case

Denver-based Fourth Corner Credit Union was established to serve the financial needs of the cannabis and hemp industries. Fourth Corner was provided a credit union charter by the Colorado Division of Financial Services in April of 2014 but was subsequently denied deposit insurance by the National Credit Union Administration. Additionally, they were denied a master account at the Federal Reserve Bank of Kansas City. A master account is effectively a bank's bank account. Master accounts at Fed branches allow banks to not only deposit their cash reserves, but gives banks the ability to easily transact business with other financial institutions by settling credits and debits through the account at that Fed branch bank. A financial institution without a master account would be prevented from conducting most types of electronic funds transfers. Fourth Corner filed legal action against the Federal Reserve Bank of Kansas City*, Fourth Corner Credit Union v. Federal Reserve Bank of Kansas City (D. Colo., 15-cv-01633).* In January of 2016 the case was dismissed leaving the hope for mainstream banking services up in smoke.

The opinion dismissing the *Fourth Corner* case outlines the major obstacles to providing banking services to state legalized cannabis businesses. The Court found,

> *"…because any affirmative legal action that Colorado takes to facilitate the distribution of marijuana is preempted by federal law." and;*
>
> *…"The Cole Memorandum" and the "FinCEN guidance" discussed at some length in the compliant do not change that analysis. And;*
>
> *"In light of the CSA, Colorado lacks the power to grant a credit union charter with the knowledge that the credit union is designed to aid and abet violations of federal law by offering banking services to businesses engaged in the manufacture and/or distribution of marijuana."*

Finally, Judge Jackson calls into question the effectiveness of the Cole Memo and FinCEN guidance and that this issue needs to be addressed by Congress:

> *Plaintiff contends that the FinCEN guidance and Cole memorandum already provide federal authorization to financial institutions to serve MRBs. Therefore, offering to serve MRBs only if authorized by federal law is something of a sleight of hand. The problem is, the FinCEN guidance and Cole memorandum do nothing of the sort. On the contrary, the Cole memorandum emphatically reiterates that the manufacture and distribution of marijuana violates the Controlled Substances Act, and that the DOJ is committed to enforcement of that Act. It directs federal prosecutors to apply certain priorities in making enforcement decisions, but it does not change the law. The FinCEN guidance acknowledges that financial transactions involving MRBs generally involve funds derived from illegal activity, and that banks must report such transactions as "suspicious activity." It then, hypocritically in my view, simplifies the reporting requirements. In short, these guidance documents simply suggest that prosecutors and bank regulators might "look the other way" if financial institutions don't mind violating the law. A federal court cannot look the*

> *other way. I regard the situation as untenable and hope that it will soon be addressed and resolved by Congress.*

An initial analysis of the decision makes it clear that the creation of a state licensed bank or credit union created for the purpose of servicing MCBs is not a legally viable option until federal law is changed.

State Bank

Periodically, the concept of creating a state run and operated financial institution has been considered as a fix for a host of issues. Recently, the state bank idea has been floated as a potential solution to provide business banking services to MCBs. A state operated financial institution generates several questions and concerns even before considering its uses for MCBs. What assets would provide the appropriate capitalization for a state bank? Would such an entity create pressures on the General Fund in the event of losses or failure of the bank? Who would be in charge of day-to-day operations? What would be the initial costs to the state to set up such a bank and pay for staff? These are only a few of the questions that generally concern the creation of a state bank. Creating a state bank to service MCBs or making the service of MCBs one part of the operation of a state bank does not eliminate the existing hurdles faced by regular financial institutions. The state bank would still need access to the Federal Reserve System and deposit insurance which the *Fourth Corner* makes clear is not legally possible.

Alternatives to Traditional Banking Relationships

The difficulties of banking MSBs has become magnified as many other states have legalized marijuana either by expanding medical marijuana usage or the full scale legalization such as in Colorado. In response to this growth several companies have created banking alternatives designed to provide electronic transactions for MCBs and assist with FinCEN and *Cole Memo* requirements. These alternatives range from kiosk type interface systems that allow customer payment and order without exchanging cash at the MCB to mobile phone applications that service as a digital wallet to allow customers to pay with their phone from an account that is preloaded with funds. Many of these systems also include inventory management, product tracking and customer transaction tracking in an attempt to comply with the requirements under federal anti-money laundering laws. A recent article (February 16, 2016) in The New York Times, *As Marijuana Sales Grow, Start-Ups Step In for Wary Banks* stated:

> *Most of the start-ups trying to help with this problem are focuses in one way or another, on tracking every detail of every purchase in a more sophisticated way. Careful record-keeping can answer the concerns of banks worried about violating anti-money laundering laws.*

Careful record keeping can assuage concerns about anti-money laundering violations, but it would be overly simplistic to state that financial institutions are concerned only with this one aspect given the various concerns already outlined in this document.

Current Federal Action

Congressman Perlmutter (D-Colorado) has introduced H.R. 2076 - Marijuana Businesses Access to Banking Act of 2015. H.R. 2076 would provide a safe harbor for depository institutions that provide products or services to legal cannabis businesses and prohibits a federal banking regulators from: (1) terminating or limiting the deposit or share insurance of a depository institution solely because it provides financial services to a cannabis-related legitimate business; or (2) prohibiting, penalizing, or otherwise discouraging a depository institution from offering such services.

Conclusion

Marijuana's inclusion under the CSA leaves states with legalized marijuana, whether for medical or recreational use, in a difficult position where any potential safe harbor is only as good so long as federal enforcement of the CSA ignores states with legalization. However, financial institutions face this problem even more directly due to their regulatory nexus with the federal government via the need for deposit insurance and access to the Federal Reserve. These are not the only considerations, as previously banking regulators have urged banks to avoid reputational risk involved with banking certain "high risk" although legal industries.

The current difficulties will only increases exponentially. The implementation of MMRSA will expand the volume of business and state licensing fees will need to be paid in addition to taxes and potential local fees. The payment of licensing fees and taxes will remain problematic until the banking question is answered. MMRSA requires an initial and yearly licensing fee which is likely to be paid in cash unless a solution is reached. Media reports suggested that cities and counties throughout the state are considering additional marijuana fees and taxes, yet these jurisdictions will have to deal with large amounts of cash to cover these payments. These are obstacles for the current legal medical marijuana industry. If the medical cannabis banking situation that exists today were to continue in event of full state legalization of recreational use of marijuana the potential volume and scale of transactions could freeze the industry as BOE and other agencies and local governments would be unable to process the cash associated with such volume.

Establishing alternatives to bank accounts may provide short-term workarounds to the current difficulties of banking MCBs such as removing large amounts of cash from the system. However, the essential deciding factor that will open up access to banking would be either a change of the CSA to remove marijuana from the list of controlled substances or the creation of a safe harbor for financial institutions that offer accounts to state legalized MCBs.

Joint Hearing of the
Assembly Banking and Finance Committee
and the Select Committee on Youth and California's Future

I. Introduction

Annual percentage rate, compound interest, adjustable rate mortgage, FICO score, reverse mortgage, universal default, prepayment penalties, negative amortization, 401(k), IRA, annuity, Certificates of Deposit, capital gain, equity, principal and balance transfer fees are just some of the terms of the contemporary financial universe. The market place functions best when educated consumers are able to make informed choices regarding their personal financial needs and goals. A well informed and financially literate consumer can save thousands of dollars at the closing table, avoid abnormal fees and charges and build up savings for retirement. Financial literacy is not only about learning the skills need to balance a check book, it is about personal empowerment.

II. What Is Financial Literacy?

The U.S. Financial Literacy and Education Commission defines financial literacy as "the ability to make informed judgments and to take effective actions regarding the current and future use and management of money." Financial literacy is not only the basic skills of balancing a checkbook, or computing interest rates, but the ability to use that information to make informed decisions about ones financial future and stability.

III. Why is Financial Literacy a Problem?

In a Financial Industry Regulatory Authority (FINRA) survey, only 42% of Californians answered at least four questions correctly on a five question financial literacy quiz. Another 2009 survey found that 80% of the respondents received scores of 60 or lower on financial questions about retirement.[38] Just 20% received what amounted to a passing grade.

The problem is even more pressing for youth, minorities, and women. According to the Jump$tart Coalition, the average high school student's score in financial literacy was 48%.[39] However, minority students fared far worse than their white counterparts; 89% of African-Americans and 83% of Latinos failed to score a passing grade on the financial literacy test compared to 64% of white students.[40] In addition, 38% of men, in contrast to 22% of women, correctly answered all three financial literacy questions in a 2014 survey.[41]

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[38] Retirement Income Literacy Survey for American College of Financial Services. (September 2014) http://www.theamericancollege.edu/ricp-retirement-income-survey/docs/Greenwald_TAC_RICP_Retirement_Income_Literacy_Survey.pdf

[39] Mandell, Lewis. The Financial Literacy of Young American Adults for the Jump$tart Coalition for Personal Financial Literacy (2008). http://views.smgww.org/assets/pdf/2008%20JumpStart%20Financial%20Literacy%20Survey.pdf

[40] Id.

[41] Knowledge@Wharton, University of Pennsylvania. "Three Questions with Implications for Your Financial Future" (February 11, 2015). http://knowledge.wharton.upenn.edu/article/three-questions-major-implications-financial-well/

A. Impacts

Financially savvy people are more likely to save, invest in stocks, and accumulate more wealth.[42] They are also less likely to have credit card debt, and when they do, they manage it better by paying off the full amount each month. They also refinance their mortgages when it makes sense, tend not to borrow against their 401(k) plans, and are less likely to use high-cost borrowing methods (e.g. payday loans, pawn shops, auto title loans, and refund anticipation loans).[43]

1. On Youth

Financial illiteracy is particularly troubling for young people entering the labor market. College students tend to have large amounts of credit card and student loan debt upon entering the workforce. Lacking a clear understanding of basic financial concepts, students are more likely to rely on high-cost methods of borrowing. Risky borrowing not only undermines future homeownership but also the ability to control one's financial future.

The Financial Industry Regulatory Authority's (FINRA) Investor Education Foundation, which seeks to promote financial literacy, revealed high school students who are required to take personal finance courses have better average credit scores and lower debt delinquency rates as young adults.

FINRA's study also found that personal finance education lowers the probability of falling 90 or more days behind on future credit accounts, especially for students who took required classes in economics or personal finance after the first-year mandates were adopted.

2. On Adults

Financial literacy also hinders adults and their hopes for retirement. Without a base knowledge of financial tools, adults are less likely to invest in retirement plans.[44] According to the Employment Benefit Research Institute, 46% of Americans have less than $10,000 saved for retirement.[45] Another survey found that 15% had not saved a single cent.[46] Currently, there is a $6.6 trillion gap between the pensions and retirement

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[42] Gale, William G. and Levin, Ruth, Financial Literacy: What Works? How Could It Be More Effective? (October, 2010). http://www.brookings.edu/research/papers/2010/10/financial-literacy-gale-levine

[43] Mitchell, Olivia S. and Lusardi, Annamaria, Financial Literacy and Economic Outcomes: Evidence and Policy Implications (January 7, 2015). Available at SSRN: http://ssrn.com/abstract=2568732 or http://dx.doi.org/10.2139/ssrn.2568732

[44] Research indicates that people who have had financial education participate more often in retirement programs, make larger contributions to the program and have a much higher savings rate than others. ("Integrating Financial Education into School Curricula," The Department of the Treasury). https://www.financialeducatorscouncil.org/financial-literacy-statistics/

[45] Employment Benefit Research Institute survey. https://www.financialeducatorscouncil.org/financial-literacy-statistics/

[46] Updegrave, Walter. How to Retire Rich in a Totally Changed World: Why You're Not in Kansas Anymore. (2007)

savings of U.S. households and what they should have to maintain their living standards in retirement.[47] Low saving and retirement participation rates could lead to a dramatic increase in the number of people on welfare and drive up costs nationally.

Increasing financial literacy can improve quality of life, both now and in retirement, raise college attainment levels, increase homeownership,[48] reduce dependence on welfare services, and decrease bankruptcy filings.[49] In addition, financial illiteracy has been identified as a major driver of income inequality with up to a third of the wealth gap being explained by the gap in financial knowledge between the wealthiest and the poorest.[50] Educating our youth to be financially literate could help slow the growing disparity between the state's highest and lowest earners.

IV. Efforts to Address Financial Literacy

A. Federal

Title V of the Fair and Accurate Credit Transaction Act (FACT Act) established the Financial Literacy and Education Commission (Commission) with the purpose of improving the financial literacy and education of persons in the United States. This program is a partnership between twenty federal agencies to provide materials and resources for those interested in providing financial literacy services and programs. Congress charged the Commission with improving "the financial literacy and education of persons in the United States through the development of a national strategy to promote financial literacy and education."

The Federal Deposit Insurance Corporation (FDIC) created Money Smart, a financial literacy program composed of ten training modules that can be used by financial institutions and schools. The FDIC also provides trainers to assist in teaching the program or to bring together interested parties to form partnerships.

B. State

The Council for Economic Education in their latest study released in 2016 titled, "Survey of the States: Economic and Personal Finance Education in our Nation's Schools," found the following:

- 20 states require high school students to take a course in economics. This is two fewer than in 2014.

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[47] Retirement Income Deficit report by Retirement USA; www.financialeducatorscouncil.org/financial-literacy-statistics/

[48] Eighty-five percent of college graduates plan to move back home after graduating. (Twentysomething Inc. 2010 survey). https://www.financialeducatorscouncil.org/financial-literacy-statistics/

[49] Providing financial education to the least educated individuals prior to their entrance into the labor market improved their well-being by an amount equivalent to 82% of their initial wealth. Mitchell, Olivia S. and Lusardi, Annamaria, The Economic Importance of Financial Literacy: Theory and Evidence. Journal of Economic Literature. (2014). *See also*, Harnisch, Thomas L., Boosting Financial Literacy in America: A Role for State Colleges and Universities. (2010) http://www.aascu.org/policy/publications/perspectives/financialliteracy.pdf

[50] Mitchell and Lusardi, (2015). Available at SSRN: http://ssrn.com/abstract=2568732 or http://dx.doi.org/10.2139/ssrn.2568732

- 17 states require high school students to take a course in personal finance. Only 5 states require a standalone semester course in personal finance.
- 16 states require testing, which is down significantly from 25 in 1998.
- 45 states include personal finance in their K–12 standards, up from 21 in 1998. (Alaska, California, Montana, New Mexico, Wyoming and the District of Columbia still do not.) 37 now require that those standards be implemented, up from 14 in 1998.
- All 50 states, plus Washington, D.C., now include economics in their K–12 standard curriculum, up from 39 in 1998. Also, 45 states, including Washington, D.C., require those standards be implemented by the districts, compared with 28 in 1998. (Alaska, Connecticut, Kansas, Massachusetts, Oklahoma and Wisconsin are the holdouts.)

C. California

Currently in California, there is no mandated curriculum on financial literacy. Due, in part, to the Local Control Funding Formula (LCFF), school districts retain broad authority over curriculum and how subjects are taught. However, many nonprofit organizations have attempted to fill the gap and provide financial education in their communities.

1. Instructional Quality Commission's Framework Update

In 2013, Governor Brown signed AB 166 (Hernández) which required the California State Board of Education (SBE) to include financial literacy in its next revision of textbooks or curricula and incorporate such topics as budgeting and managing credit, student loans, consumer debt, and identity theft security. Consistent with this requirement and its defined duties as a subsidiary of the SBE, the Instructional Quality Commission (IQC) convened in 2014 to update the History-Social Science Framework.[51]

On November 20, 2015, the IQC approved and released for public comment the 2014-2016 Draft History-Social Science Framework for second review. As part of this framework, and consistent with AB 166, the IQC included financial education topics in its framework for Principles of Economics. Principles of Economics is a one-semester required course for grade 12 high school students. The framework suggests that students learn how to budget effectively by having hands on learning modules where they must develop and stick to a monthly budget with a mock monthly salary. The framework suggests that this module build upon itself by teaching students about debt and different ways to accumulate personal wealth in addition to learning about credit card payments, student loan debt, and mortgages as well as how the stock market operates.

The IQC is in the process of preparing its advisory report to the SBE on the 2014-2016 Draft History-Social Science Framework. Upon approval, it is possible that financial education curricula could be implemented by districts for the 2017-2018 school year.

[51] For more information on the IQC's duties and membership see http://www.cde.ca.gov/be/cc/cd/index.asp

2. Independent Financial Literacy Programs

While California does not require financial education curricula for each student, there are multiple programs that attempt to fill this gap throughout the state. Below are short profiles of just a few of these organizations.

a. Bank on California

Too many Californians are financially illiterate and unbanked or underbanked. The goal of the Bank on California Program is to encourage voluntary collaborative partnerships that work together to lower the number of unbanked and to get more Californians to enter the financial mainstream. With a bank account, unbanked Californians can achieve financial security, start to save for the future, and establish a credit history.

Since Bank on California launched in 2008 without statutory oversight, the program has been housed in several state departments including the Governor's Office of Planning and Research, the State and Consumer Services Agency, and found a home in the Department of Financial Institutions now known as DBO in 2012. Due to the program's history of inconsistent resources and leadership prior to DBO, it is difficult to determine the success of the program. The program has thrived predominantly due to the local level programs and the large-scale recognition of Bank on San Francisco. AB 1292 ((Dababneh) Chapter 750, Statutes of 2015) created long-term stability and guidance to the Bank On programs. The state provides no funding for the Bank on California program and most activities are operated by regional coalitions using local government and non-public funding from nonprofits and private companies.

Bank on California involves a voluntary partnership between certain financial institutions and cities, is intended to increase the supply of starter account products offered by participating financial institutions, raise awareness among unbanked individuals about the benefits of account ownership, and make quality money management education more easily available to un- and underbanked individuals.

According to research conducted by the U.S. Treasury, statewide initiatives have the opportunity to serve two important roles. First, Bank on California "can help cultivate new local programs by providing technical assistance, leveraging connections with statewide partners and assisting local programs in understanding financial regulations. Additionally, they can help leaders of statewide Bank On programs share best practices and resources. It is important that statewide programs clearly define their role and their relationship with existing local Bank On programs."

Second, Bank on California may "also be able to overcome financial access challenges facing rural areas and smaller towns, which often lack the resources and infrastructure necessary to get a Bank On effort off the ground."

Bank on California, as the first established state-wide program in the nation, is a leader but the longevity of the program remains unstable. Bank on California has the ability to organize local programs, provide a clear and focused point of contact for financial institutions participating in multiple local programs, and provide technical assistance and other support to reduce the burden on local programs and financial institutions.

Bank on California is necessary to:

- Financially empower lower income consumers by making it easier and more affordable for them to deposit their paychecks, pay their bills, and start saving.
- Increase the supply of starter account products that work for the low-income, unbanked Californians by developing baseline product criteria that must be offered by all participating financial institutions.
- Raise awareness amongst unbanked consumers about the benefits of account ownership and spurs Californians to open accounts.
- Make quality money management education more easily available to low-income Californians and raises statewide awareness of the unbanked problem and potential solutions.

b. CalCPA Dollars & Sense

Dollars & Sense is CalCPA's financial literacy initiative designed to improve financial literacy in California.[52] Dollars & Sense workshops are jointly hosted by CalCPA and local entities such as schools, businesses, PTAs, nonprofit organizations, community centers, state legislators, and more. CalCPA provides three to four volunteers to lead a 45-60 minute presentation on financial topics such as budgeting, money management, managing credit cards, saving and investing, tax tips, and financial preparedness. The presentation is followed by an hour of questions and answers with the audience. CalCPA also provides take-home materials for audience participants.

Dollars & Sense has a customizable curriculum that can be tailored to college students, graduates, parents, small businesses, home owners, as well as a module for high school students developed in collaboration with NEFE.

c. California Jump$tart Coalition

The CA Jump$tart Coalition is a not-for-profit organization affiliated with the National Jump$tart Coalition for Personal Financial Literacy. The purpose of the California Jump$tart Coalition is to improve the quality of life in California by teaching young people how to succeed with money, including organization, earning, spending, saving, investing and credit.[53] Its mission is to improve the personal financial literacy of California's youth in two ways. First, by helping the personal finance education community become more connected, effective, and powerful and second by supporting the implementation of personal finance education at every level in K12.

Jump$tart's members are individuals and organizations who recognize and support the lifetime benefits of personal financial education, including teachers, corporations, CPA's, banks, credit unions, not-for-profits, school administrators, school districts, boards of education, parents and students.

Jump$tart also funds research and surveys on the prevalence of financial illiteracy and the efficacy of financial education curricula and programs to determine the best methods to address this issue.

[52] For more information about CalCPA and Dollars &Sense see http://www.calcpa.org/public-resources/financial-literacy/dollars-and-sense

[53] For more information about the California Jump$tart Coalition see http://www.cajumpstart.org/about-us

d. National Endowment for Financial Education and CashCourse

Founded in 1972, the National Endowment for Financial Education (NEFE) is a self-funded private foundation that provides free financial education resources to both high school and college students. NEFE funds cutting edge research on financial literacy and provides its High School Financial Planning Program (HSFPP) curriculum to over 5,000 schools and programs. It also developed and provides its CashCourse online financial education program to schools across the country.[54] CashCourse is used by more than 70,000 students in more than 900 schools—including small private colleges, large public universities and both two-year and four-year programs—in all 50 states. In California, CashCourse is available at 8 CSU campuses, 9 UC campuses, and over 100 community colleges across the state.

CashCourse goes beyond just discussing financial aid and student loans, and covers everything from basic financial skills like budgeting and credit cards to prepare for post-college life, finding a job, repaying loans and knowing what to do in a financial crisis. While CashCourse isn't a traditional Default Prevention program, by helping students build financial skills that apply to each area of their lives they are better prepared for both success in college and after graduation.

e. Operation HOPE: Banking on Our Future

The mission of Operation HOPE, Inc. (HOPE) is financial dignity, making free enterprise work for everyone.[55] HOPE works on the ground as the nonprofit private banker for the working poor, the underserved and struggling middle class.

HOPE's Banking on Our Future (BOOF) division focuses on keeping the most at risk youth from repeating the cycles of poverty and despair that has trapped so many in their families and communities by teaching them basic financial literacy. BOOF elevates the dignity, hope, and economic self-sufficiency of people in low-wealth and underserved communities through financial literacy. Since its inception, the Banking on Our Future Program has reached over 910,000 students in more than 3,176 schools and community-based organizations in the U.S. and South Africa.

Banking on Our Future classes are free of charge for schools and communities. The program is led by HOPE Corps volunteers who have undergone comprehensive training in financial literacy and teaching techniques. Our BOOF students are given the tools they need to take control of their financial futures - by learning about empowerment, responsibility, and hope.

f. YWCA-Berkeley Financial Literacy Program

Founded in 2011, YWCA Berkeley/Oakland's High School Financial Literacy Program is designed to empower Oakland public high school students to learn the

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[54] For more information about NEFE and CashCourse see http://www.nefe.org/ and http://info.cashcourse.org/about/about-cashcourse.aspx

[55] For more information about Operation HOPE and Banking on Our Future see http://www.operationhope.org/program/pid/1#sthash.Syh8Z8kn.dpuf

essentials of personal finance.[56] Through hands-on, interactive activities students develop the skills and knowledge they need to make good financial decisions throughout their lives. In addition to benefitting high school students, this unique program provides UC Berkeley students with the opportunity to develop leadership and teaching skills, as well as to give back to their community.

Since its inception over 65 UC Berkeley students have volunteered to teach over 1,400 students at 7 Oakland high schools. The program is seven to eight weeks and focuses on the following topics:

- Understanding the beliefs that formulate our financial choices.
- Financial goal setting to create achievable goals that can be broken into actionable steps.
- Budgeting and making good financial choices.
- Types of bank accounts and their use, and the purpose of saving money.
- How interest is calculated and why time is an important factor in saving.
- The process of the stock market and the impact of risk.
- How a credit score is calculated and its impact financially.
- Consumer awareness promoted through identifying advertising techniques and the cost of common items.
- Information on choosing a career, applying to college and financial aid.
- Basics of taxes and the difference between an employee and independent contractor.

In addition, the YWCA-Berkeley hosts an annual Young Women and Money Conference as well as regular community workshops. Both initiatives are geared towards increasing financial knowledge regarding credit cards, interest rates, mortgages, checking and savings accounts, and retirement strategies. Through its Financial Literacy Program, Young Women and Money Conference and its financial education workshops, YWCA-Berkeley is committed to improving financial literacy in its community.

V. Conclusion

Financial literacy is a growing issue and is already affecting Californians in a myriad of ways. Financial illiteracy depresses college graduation rates, homeownership, and increases dependence on welfare services, the number of bankruptcy filings, as well as mortgage default rates. Research shows that financial literacy should be treated early, in our K-12 education system, in order to prevent these consequences from negatively impacting our youth and their future. Yet, a new K-12 curriculum isn't the only salve for this problem; there are numerous private entities and nonprofit organizations working diligently to improve financial literacy in our state. Moving forward, the goal of the legislature must be to address existing gaps in these approaches and ensure that the next generation doesn't lose out on the American dream simply because we didn't give them the tools needed for success.

[56] For more information on the YWCA-Berkeley's Financial Literacy Program see http://www.ywca-berkeley.org/financial-literacy/

"Keeping Up With PACE: A Joint Oversight Hearing on Residential Property Assessed Clean Energy Programs"

Assembly Committee on Banking and Finance

Thursday, June 9, 2016
10:00 a.m. – 1:00 p.m.
Room 437

Introduction:

In 2008, under AB 811 (Levine & Beall), the Legislature found the following:

> *"Energy and water conservation efforts, including the promotion of energy efficiency improvements to residential, commercial, industrial, agricultural, or other real property are necessary to address the issue of global climate change.*
>
> *The upfront cost of making residential, commercial, industrial, agricultural, or other real property more energy and water efficient prevents many property owners from making those improvements. To make those improvements more affordable and to promote the installation of those improvements, it is necessary to authorize an alternative procedure for authorizing assessments to finance the cost of energy and water efficiency improvements.*
>
> *The Legislature declares that a public purpose will be served by a voluntary contractual assessment program that provides the legislative body of any public agency with the authority to finance the installation of distributed generation renewable energy sources and energy or water efficiency improvements that are permanently fixed to residential, commercial, industrial, agricultural, or other real property"*

Almost 10 years later, the intent of the Property Assessed Clean (PACE) Program remains which is, "energy and water conservations efforts...are necessary to address the issue of global climate change." California enacted the first statewide PACE Program in 2008 to combat climate change. Since 2008, the PACE program has spread across the state through cities and counties adopting resolutions and at least 31 other states have created their own PACE program with variations.

When created, it was presumed that public agencies would run the PACE program themselves; instead the majority of cities or counties have contracted out the services to new unregulated private entities to administer the PACE program. Only one program runs their own PACE program internally: Placer County.

Additionally, when established, the Legislature did not foresee the attention the PACE program would receive from the Federal Housing Finance Agency (FHFA) and the Federal Housing Administration (FHA) or the impact the PACE program could have on California's housing market.

The PACE program continues to gain traction among California homeowners who want to improve their carbon footprint and need a financing alternative to allow them the opportunity. With every newly created program, unintended hurdles appear (discussed below). During this joint oversight hearing we will examine these hurdles and determine how best to move forward with the goal to improve and strengthen the PACE program.

Background:

PACE is an innovative financing tool that residential or commercial property owners can use to pay for renewable energy upgrades, energy, or water efficiency, or electric vehicle charging stations for their homes or buildings. Local agencies created PACE assessment districts in their jurisdictions via a resolution of their legislative body, allowing the local agency to issue bonds to finance the up-front costs of improvements. In turn, property owners enter into a voluntary contractual assessment agreement with the local agency to re-pay the bonds via an assessment on their property tax bill. The assessment remains with the property even if it is sold or transferred, and the improvements must be permanently fixed to the property.

PACE programs typically are more attractive to borrowers and lenders because they can offer a longer pay-back period (up to 20 years) with smaller payments than other types of loans, and they are securitized by the property assessment rather than the borrower.

FHFA

On July 6, 2010, Fannie Mae and Freddie Mac stated that they would no longer purchase mortgage loans secured by properties with outstanding PACE loans. The FHFA announcement states:

> "First liens established by PACE loans are unlike routine tax assessments and pose unusual and difficult risk management challenges for lenders, servicers and mortgage securities investors. The size and duration of PACE loans exceed typical local tax programs and do not have the traditional community benefits associated with taxing initiatives.
>
> FHFA urged state and local governments to reconsider these programs and continues to call for a pause in such programs so concerns can be addressed. First liens for such loans represent a key alteration of traditional mortgage lending practice. They present significant risk to lenders and secondary market entities, may alter valuations for mortgage-backed securities and are not essential for successful programs to spur energy conservation."

The State of California and several other parties sued FHFA for not conducting a formal rulemaking before its decision; however, the 9th Circuit Court of Appeals ruled in FHFA's favor in March of 2013. (County of Sonoma, et al. v. Federal Housing Finance Agency, 710 F.3d 987 (2013)).

On December 22, 2014, the FHFA once again alerted homeowners, financial institutions, and state authorities of FHFAs concerns with state-level that threaten the first-lien status of single-family loans owned or guaranteed by Fannie Mae and Freddie Mac. FHFA stated**,**

> *"The existence of these super-priority liens increases the risk of losses to taxpayers. Fannie Mae and Freddie Mac, while operating in conservatorship, currently support the housing finance market by purchasing, guaranteeing, and securitizing single-family mortgages. One of the bedrock principles in this process is that the mortgages supported by Fannie Mae and Freddie Mac must remain in first-lien position, meaning that they have first priority in receiving the proceeds from selling a house in foreclosure. As a result, any lien from a loan added after origination should not be able to jump in line ahead of a Fannie Mae or Freddie Mac mortgage to collect the proceeds of the sale of a foreclosed property. Localities offering these PACE loans threaten to move existing Fannie Mae and Freddie Mac mortgages to a second lien position and increase the risk of loss to the Enterprises and, by extension, to taxpayers.*
>
> *In issuing this statement, FHFA wants to make clear to homeowners, lenders, other financial institutions, state officials, and the public that Fannie Mae and Freddie Mac's policies prohibit the purchase of a mortgage where the property has a first-lien PACE loan attached to it. This restriction has two potential implications for borrowers. First, a homeowner with a first-lien PACE loan cannot refinance their existing mortgage with a*

Fannie Mae or Freddie Mac mortgage. Second, anyone wanting to buy a home that already has a first-lien PACE loan cannot use a Fannie Mae or Freddie Mac loan for the purchase. These restrictions may reduce the marketability of the house or require the homeowner to pay off the PACE loan before selling the house."

California PACE Loss Reserve Program (LRP)

In 2013, Senate Bill 96 (Budget Committee), directed CAEATFA to develop the PACE LRP to mitigate the potential risk to mortgage lenders associated with residential PACE financing. The $10 million Loss Reserve makes the first mortgage lenders whole for any losses in a foreclosure or a forced sale that are attributable to a PACE lien covered under the LRP. The goal of the LRP is to put first mortgage lenders in the same position they would be in without a PACE lien.

PACE administrators can participate in the LRP by applying to CAEATFA and demonstrating that they meet the LRP's minimum underwriting criteria. Once a PACE program is enrolled, the Loss Reserve will cover assessments issued by that program for their full terms, or until funds are exhausted. Enrolled PACE programs report their financing activity to CAEATFA semi-annually. To date, no claims have been made on the LRP.

In May of 2014, FHFA responded to California's PACE LRP by stating,

> "FHFA has carefully reviewed the Reserve Fund created by the State of California and while, I appreciate that it is intended to mitigate these increased losses, it fails to offer full loss protection to the Enterprises. The Reserve Fund is not an adequate substitute for Enterprise mortgages maintaining a first lien position and FHFA also has concerns about the Reserve Fund's ongoing sustainability."

Department of Housing and Urban Development- FHA

In August, 2015, FHA announced the development of Single Family PACE guidance. The Single Family FHA guidance will address the impact of PACE assessments on purchases, refinances and loan modification options available to borrowers experiencing distress and will require subordination of PACE financing to the first lien FHA mortgage. FHA stated the guidance at a minimum will include the following:

- Lien position: only PACE liens that preserve payment priority for first lien mortgages through subordination;
- PACE payment, structure, and term: PACE financing must be fixed rate, fully amortizing loan;
- Eligible properties: PACE assessments must be attached to single family properties, as defined by FHA, which are 1 to 4-unit dwellings, including detached, semi-detached and townhome properties;
- Equity requirements: PACE liens that preserve payment priority for first lien mortgages will be eligible for financing that does not exceed FHA's maximum combined loan-to-value ratio;
- Record keeping: PACE liens must be formally recorded and be identifiable to a mortgage lender through a title search;

- Additional consumer protections: PACE programs must comply with applicable federal and state consumer laws and should include disclosures to and training for homeowners participating in the program.

Concerns with PACE:

The following are concerns with the current administration of the PACE program:

Refinancing: A person with a traditional PACE lien which has super priority status may not be able to obtain refinancing with a loan which conforms to current Fannie Mae or Freddie Mac guidelines, which represents the vast majority of conventional refinancing. Fannie Mae and Freddie Mac policies prohibit them from purchasing a mortgage with a PACE lien on it. This greatly limits, if not eliminates, the ability of a borrower to refinance the property if there is a PACE super priority lien. Certain programs have advertised that many homeowners have been able to refinance their property with PACE liens, but it is likely most of those were done prior to July 6, 2010 or the homeowners are using non-conventional financing which may carry higher interest rates.

Selling: A homeowner with a PACE lien may have difficulty selling his or her property to buyers with conventional loans. Fannie Mae and Freddie Mac are prohibited from purchasing a mortgage with a PACE lien on it. Therefore a buyer who is using conventional financing will likely be unable to purchase a home with the lien, as most conventional mortgages will conform to Fannie Mae and Freddie Mac guidelines. Sellers would be limited to those persons who are cash buyers, or buyers who have loans from lenders who make loans which do not conform to Fannie Mae or Freddie Mac guidelines and only where such loans omit provisions restricting the ability to borrow with the super priority lien.

Senior Lien/Lien Subordination: The voluntary contractual assessments that borrowers enter into result in a senior lien on the property. A lien occurs when an assessment, obligation, or claim (debt) is secured by the value of your property, such as a mortgage. The lien attached to a property in connection with the contractual assessment has “senior” lien status, which means that it has priority and must be satisfied before any other private liens, including a mortgage. The foreclosure of a property subject to a senior lien will terminate all other liens on the property with a lower priority. A number of PACE programs are offering to subordinate PACE liens at the request of a homeowner. Lien subordination is the industry response to FHFA and FHA but it is unclear how it works, how it is offered and how it impacts the PACE program.

Lack of consumer protections: The current PACE program lacks disclosure requirements in statute. Borrowers should fully understand these restrictions prior to taking out a first-lien PACE loan. PACE loan underwriting conducted by public agencies or private entities lacks basic standards with federal lending laws. Potential borrowers are not evaluated for their ability to repay, there are insufficient parameters for debt-to-income or loan-to-value ratios, and consumer disclosures are inadequate failing to clearly identify the terms and conditions of the loan and the subsequent impact such loans have on existing mortgages and the consumer’s ability to sell or refinance their home.

Number of PACE Loans: It is also unclear how many PACE loans can be made on a single parcel. A single property may therefore have a super-priority lien established for a loan made for solar efficiency, a separate loan for water efficiency and a third loan for seismic strengthening improvements. The potential stacking of these PACE loans further complicates title and the rights of other prior lienholders.

Oversight: Currently, the PACE program lacks oversight and regulatory enforcement. These newly created third party providers have no regulator to ensure consumers are provided with necessary disclosures and protections. This hearing will examine the oversight that is being provided by local governments, including JPAs, on the practices of contractors, the relationship between third party providers and contractors.

PACE Financing:

PACE was created as a financing alternative for homeowners in hopes of encouraging energy efficiency across the state. Homeowners can use PACE for various energy efficiency improvements such as solar panels, irrigation components, windows, HVAC systems, etc. PACE allows a homeowner to apply for PACE financing, if approved the money financed runs with the property rather than the homeowner for up to 20 years. PACE providers encourage homeowners to participate by telling them PACE is:

- Easy and simple to qualify
- Adds value to the home
- Financing is not based on the owner's annual income
- Assessments do not appear on your credit report - personal credit score has no impact on funding eligibility or interest rate
- Assessments are paid semi-annually along with your property taxes
- Assessments may be passed to subsequent property owners
- 0% down- 100% financing- no payment until December 2017
- Terms and tax advantages deliver the lowest monthly payments – saving you 50% or more over traditional financing.

Prepayment penalties: According to the Sonoma County program: initial bond financing for improvements is held by the Sonoma County Treasury, and there is no penalty while the County Treasury holds the note. However, in order to continue to provide funding for Program growth, this investment will at some point be converted to long-term bonds. Bond purchasers generally require an early payment penalty/premium of up to 3%, based on current conditions. Please note that while a homeowner can pay off the assessment completely, the County of Sonoma cannot accept partial prepayments. Because PACE Financing is through the sale of bonds, any early payoff would need to include interest due until the next semi-annual bond payment date, which under state law is either March 2 or September 2.

Interest rates: Interest rates vary depending on the program, but tend to be higher than they would be for home equity loans. A review of various programs showed rates in a range from 6.95 to 9.25% which varied on a number of factors including the amount borrowed, and the duration of the assessment.

Conclusion:

The value and importance of the PACE program to the state of California does not need to be debated. Thus far, the PACE program has allowed thousands of homeowners afford energy efficient upgrades that homeowners may not have otherwise been able to afford. To address the unintended concerns (discussed above), during the 2016 legislative session, AB 2693 was introduced to require a uniform disclosure form and additional much needed consumer protections. As the PACE program enters its 10 year anniversary and as we approach the next housing cycle, California needs to be prepared for the next wave of foreclosures with PACE liens attached to them.

In the News:

- Mark Chacon: Energy-efficiency loans could cause homeowner headaches

Even if you can afford to pay off the liens before the sale closes, that reduces the amount you can realize from the sale. And even if you find an all-cash buyer, because the assessment will transfer with the property, that's an added cost many prospective buyers won't want to deal with.

Steve Lista found that out the hard way. He put his five-bedroom home in Riverside County on the market in June but couldn't find a buyer willing to take on the $3,000-a-year assessment for his $27,000 solar panel system.

(http://www.vcstar.com/opinion/columnists/mark-chacon-energy-efficiency-loans-could-cause-homeowner-headaches-2f20c692-4bb8-17c7-e053-0100007f-375102471.html)

- Energy improvement program can hobble home sales

When Patti Smith sought a refinance last year for her senior community home in San Diego County, she had to pay off a $14,774 HERO loan she previously took out for an air-conditioning unit, tankless water heater and replacement ductwork.

"I was flabbergasted when our mortgage company told us we had a lien," said Smith, 62. "The contractor who pushed the HERO program never mentioned the word 'lien.' If he would have we would have never done it."

Smith said she also had to pay a penalty of $1,734.14 to HERO for paying off the loan early. The HERO program has since waived the penalty fee for homeowners.

(http://www.sacbee.com/news/business/real-estate-news/article27528559.html#storylink=cpy)

- A Growing Green Debt?

Last September, Erin Stumpf of Dunnigan Realtors met with a homeowner in Sacramento's Tallac Village neighborhood. The owner wanted to sell, and she'd replaced her yard with artificial turf, taking out a $7,000 PACE loan to do it. "Oh, but don't worry," the homeowner told Stumpf. "The PACE loan will be transferred to the new owner."

Stumpf had to explain that wasn't true. The prospective buyer likely wouldn't be able to get a mortgage because of the PACE loan — Fannie Mae and Freddie Mac, which guarantee 90 percent of the country's home loans, won't do so for properties with a PACE lien. The seller fortunately had enough home equity and used it to pay off her turf at the time of the sale.

Because she cleared her loan early, she was also hit with a prepayment penalty of at least $800, Stumpf says. "The way this was sold to my client and the way that it's sold to the public in general is really misleading," Stumpf says.

(http://www.comstocksmag.com/article/growing-green-debt)

- Clean Energy Loans Make Sales Messy- Wall Street Journal- 11/7/2015

Lori Laine's foray into a California clean-energy program made it tough for her to sell her house and ended up costing her hundreds of dollars and months of aggravation.

The culprit: a nearly $8,000 loan she took out last year to pay for a new air-conditioning unit to replace her broken one, part of a statewide push to promote clean energy with low-interest loans.

"I would never do this again," Ms. Laine said.

Ms. Laine said her air-conditioning contractor told her the financing would transfer to a new owner if she sold the home, though she admits the documents she signed from San Diego-based lender Renovate America Inc. stated there could be difficulties.

When she tried to sell her Highland, Calif., home last October, the buyer said Ms. Laine would need to pay off the balance in full before the buyer could get a mortgage.

Ms. Laine took the home off the market in hopes the rules would change, but earlier this year, she gave in and paid it off in order to sell the house.

PACE Legislation:

AB 2693 (Dababneh) would add consumer protections to the PACE program by requiring a unified disclosure. Set to be heard in Senate Governance and Finance on June 15.

AB 2597 (Ting, Chapter 614, Statutes of 2014) revised the CAEATFA underwriting standard for the PACE program by increasing the maximum amount of an assessment from 10 percent to 15 percent of the property value and specifies that PACE financing is an "assessment" or "financing" (as appropriate) and not a "loan."

AB 1883 (Skinner, Chapter 599, Statutes of 2014) allowed a public agency to transfer voluntary contractual assessments, if bonds have not been issued, as specified.

SB 96 (Committee on Budget and Fiscal Review, Chapter 356, Statutes of 2013) required the California Alternative Energy and Advanced Transportation Financing Authority to develop and administer a risk mitigation program for PACE loans.

SB 555 (Hancock, Chapter 493, Statutes of 2011) added the acquisition, installation, and improvement of energy efficiency, water conservation, and renewable energy improvements that are affixed to the types of facilities that a community facilities district (CFD) may finance, or refinance, regardless of whether the buildings or property are privately or publicly owned.

SB 1340 (Kehoe, Chapter 649, Statutes of 2010) expanded the use of voluntary contractual assessments to finance electric vehicle charging infrastructure and correspondingly expanded the PACE bond reserve program.

SB 77 (Pavley, Chapter 15, Statutes of 2010) authorized CAEATFA to develop and administer a state PACE bond reserve program to pay bondholders in the event a PACE program had insufficient funds, which would reduce risk to bondholders and facilitate smaller interest rates. CAEATFA has suspended development of this program pending resolution of FHFA's concerns described above.

AB 44 (Blakeslee, Chapter 564, Statutes of 2010) expanded the use of voluntary contractual assessments to include financing of power purchase agreements, and prohibited contractual assessments if the total amount of the assessments and taxes on the property exceeds 5% of the property's market value.

AB 474 (Blumenfield, Chapter 444, Statutes of 2009) expanded local agencies' PACE authorization to include water efficiency projects.

AB 811 (Levine, Chapter 159, Statutes of 2008) authorized all cities and counties in California to designate areas within which city officials and willing property owners may enter into contractual assessments to finance the installation of distributed generation renewable energy sources and energy efficiency improvements.

Assembly Banking and Finance Committee

Oversight Hearing

Wells Fargo Settlement of Claims Relating to Unauthorized Accounts

Background:

On December 21, 2013 the Los Angeles Times published an investigative report revealing an environment at Wells Fargo that encouraged intense cross-selling activities of Wells Fargo employees, *Wells Fargo's Pressure-Cooker Sales Culture Comes at a Cost.* The *Times* investigation found that Wells had a culture and environment that encouraged and incentivized aggressive sales tactics to meet add-on services goals. In order to meet quotas, employees opened accounts for customers without their consent, ordered credit cards without permission and in some cases forged client signatures on paperwork. Former employees interviewed for the LA Times story admitted to opening unneeded accounts to meet sales quotes and in some cases asking family members to open ghost accounts. The sales quotas were not abstract goals expected of employees. Former employees have said that managers coached employees on ways to inflate sales numbers. These sales tactics resulted in the opening of at least 1.5 million deposit accounts and 565,443 credit card accounts on behalf of customers without their knowledge or consent with approximately 14,000 of these accounts accruing $403,145 in fees.[57]

Wells Fargo is the nation's leading bank in selling add-on services to its customers and promotes this cross-selling in its earnings reports. The bank expects branch employees to sell at least four financial products to 80% of their customers, and top executives have touted the "Great 8" an average of eight products per household. These sales quotas were enforced by constant monitoring. Daily sales for each branch, and each sales employee were reported and discussed by district managers four times a day. Those failing to meet goals were approached by management and reprimanded. Quotas were also not limited to daily goals, as tellers were expected to generate at least 100 sales of products per quarter.

On May 4, 2015 the Los Angeles City Attorney filed suit against Wells Fargo claiming violations of California's Unfair Competition Law (B&P Code, §17200). The declarations included:

> *Wells Fargo imposes unrealistic sales quotas on its employees, and has adopted policies that have, predictably and naturally, driven its bankers to engage in fraudulent behavior to meet those unreachable goals. As a result, Wells Fargo's employees have engaged in unfair, unlawful, and fraudulent conduct, including opening customer accounts, and issuing credit cards, without authorization…Wells Fargo further victimized its customers by failing to inform them of the breaches, refund fees they were owed, or otherwise remedy the injuries that Wells Fargo and its bankers have caused.*

The City of Los Angeles action against Wells Fargo spurred investigations by the Consumer Financial Protection Bureau (CFPB), the Office of the Comptroller of the Currency (OCC) into the cross selling practices and unauthorized account openings of Wells Fargo. The OCC investigation concluded that the actions of Wells were unsafe and unsound business practices. Specifically the OCC found:

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[57] Wells Fargo Fined $185 Million for Opening Accounts With Customers' Knowledge. Forbes. September 8th, 2016. http://www.forbes.com/sites/maggiemcgrath/2016/09/08/wells-fargo-fined-185-million-for-opening-accounts-without-customers-knowledge/#eaec3085d7a7

1) The incentive compensation program and plans within the Wells Fargo Community Bank Group were not aligned properly with local branch traffic, staff turnover, or customer demand, and they fostered the unsafe or unsound sales pressured Bank employees to sell bank products not authorized by the customer.

2) Wells Fargo lacked an Enterprise-Wide Sales Practices Oversight Program and thus failed to provide sufficient oversight to prevent and detect the unsafe or unsound sales practices.

3) Wells Fargo lacked a comprehensive customer complaint monitoring process that impeded the bank's ability to:

   a) assess customer complaint activity across the Bank;

   b) adequately monitor, manage, and report on customer complaints; and

   c) analyze and understand the potential risk of sales practices.

4) Wells Fargo Community Bank Group failed to adequately oversee sales practices and failed to adequately test and monitor branch employee sales practices.

5) Wells Fargo audit coverage was inadequate because it failed to include in its scope an enterprise-wide view of the Bank's sales practices.

In the course of its ongoing supervision, the OCC has identified the following unsafe or unsound sales practices in the Wells Fargo Community Bank Group:

1) The selling of unwanted deposit or credit card accounts.

2) The unauthorized opening of deposit or credit card accounts.

3) The transfer of funds from authorized, existing accounts to unauthorized accounts ("simulated funding").

4) Unauthorized credit inquiries for purposes of the conduct

As a result of these findings the OCC levied a civil penalty against Wells Fargo of $35 million

CFPB:

The CFPB investigation found the following:

Opening deposit accounts and transferring funds without authorization: According to the bank's own analysis, employees opened roughly 1.5 million deposit accounts that may not have been authorized by consumers. Employees then transferred funds from consumers' authorized accounts to temporarily fund the new, unauthorized accounts. This widespread practice gave the employees credit for opening the new accounts, allowing them to earn additional compensation and to meet the bank's sales goals. Consumers, in turn, were sometimes harmed because the bank charged them for insufficient funds or overdraft fees because the money was not in their original accounts.

Applying for credit card accounts without authorization: According to the bank's own analysis, Wells Fargo employees applied for roughly 565,000 credit card accounts that may not have been authorized by consumers. On those unauthorized credit cards, many consumers incurred annual fees, as well as associated finance or interest charges and other fees.

Issuing and activating debit cards without authorization: Wells Fargo employees requested and issued debit cards without consumers' knowledge or consent, going so far as to create PINs without telling consumers.

Creating phony email addresses to enroll consumers in online-banking services: Wells Fargo employees created phony email addresses not belonging to consumers to enroll them in online-banking services without their knowledge or consent.

CFPB Enforcement:

Under the Dodd-Frank Wall Street Reform and Consumer Protection Act, the CFPB has the authority to take action against institutions violating consumer financial laws, including engaging in unfair, deceptive, or abusive acts or practices.

Pay full refunds to consumers: Wells Fargo must refund all affected consumers the sum of all monthly maintenance fees, nonsufficient fund fees, overdraft charges, and other fees they paid because of the creation of the unauthorized accounts. These refunds are expected to total at least $2.5 million. Consumers are not required to take any action to get refunds to which they are entitled.

Ensure proper sales practices: Wells Fargo must hire an independent consultant to conduct a thorough review of its procedures. Recommendations may include requiring employees to undergo ethical-sales training and reviewing the bank's performance measurements and sales goals to make sure they are consistent with preventing improper sales practices.

Pay a $100 million fine: Wells Fargo will pay a $100 million penalty to the CFPB's Civil Penalty Fund. It is the largest penalty ever levied by CFPB.

City of Los Angeles

In spite of initially claiming that the City of Los Angeles did not have jurisdiction to sue Wells Fargo, the bank settled with the city. The settlement calls for restitution for consumers and a $50 million fine, the largest such payment in the history of the city attorney's office.[58] In addition, Wells Fargo must provide the following written notice to deposit and credit card account holders in California:

[58] Settlement Document available at http://freepdfhosting.com/29677883a9.pdf

It's important for you to have peace of mind. We want to ensure you're comfortable with your accounts and have the tools you need to manage your money. We recommend you visit your local Wells Fargo bank location, or call the toll-free number that appears on this statement, to make sure you are satisfied with all your accounts and services. We'll spend time understanding your financial needs and reviewing your accounts and options. We'll also help you close any accounts or discontinue services you do not recognize or want, and discuss the process that's been established to address any remaining concerns resulting from accounts and services opened on your behalf.

In order to comply with the settlement with the Los Angeles City Attorney Wells Fargo must also comply with the following:

- Establish policies and procedures that ensure that customers receive the appropriate information about any accounts that are directly owned by the customer.
- Provide a current statement of any account the customer owns.
- When a customer closes an account, provide a written receipt that confirms account closure.
- The forms required shall be provided to customers in Spanish when requested.

Wells Fargo is required to hire an independent third party consulting firm to help identify customers that may have unauthorized accounts in their name. In those cases where current or former customers may have sustained a direct monetary loss exceeding $1 as a result of unauthorized accounts, Wells Fargo shall identify affected customers and provide written notice informing those customers that Wells Fargo will reimburse the customer for any fees or other charges that were paid by the customers for unauthorized accounts. Notice and reimbursement must be completed 90 days from the date of the settlement.

The L.A. City settlement also establishes a mediation process for current or former customers that contend they incurred fees or were harmed as a result of unauthorized accounts. Customers who make a compliant in a Wells Fargo branch location in California, or that call the Wells Fargo Feedback toll-free number asserting that they have unauthorized accounts shall be sent a notice with details concerning the mediation program within 60 days of the compliant.

Wells Fargo is required, for at least two years after the settlement to conduct an internal audit every six months to report on compliance with the obligations of the settlement.

<u>Additional Actions:</u>

In addition to the settlement fines and restitution to be provided to customers, Wells Fargo has fired over 5,000 employees during the last several years that they claim were responsible for the creation of phony accounts. Though, it is still unclear what level of responsibility these employees had for creating this problem or which among them were in a position to enforce the cross selling policies. Several former Wells Fargo employees have filed a class action lawsuit in federal court against the bank seeking $7.2 billion for workers nationwide who were fired or demoted after refusing to open fake accounts. The United States Department of Labor is currently conducting a review of Wells Fargo relating to whistleblower complaints, as well as potential wage and hour violations.[59]

At the time of this writing, Wells Fargo has announced the claw back of compensation valued at $41 million from chairman and chief executive, John G. Stumpf.[60] Additionally, Carrie Tolstedt, former leader of the Wells Fargo community banking division will surrender stock valued at about $19 million. Both executives will forgo any bonus payments for the year.

On September 28, 2016 California State Treasurer John Chiang announced that he was cutting ties with Wells Fargo for at least one year in response to the consent orders and the activities of Wells Fargo that have come to light. The action by the Treasurer includes the suspension of investments by the Treasurer's Office in all Wells Fargo securities, suspending the use of Wells Fargo as a broker-dealer for purchasing of investments and suspension of Wells Fargo in its underwriting capacity for California state bonds. The Treasurer further provided that he will use his seat on the board of the California Public Employee's Retirement System and the California State Teachers' Retirement System to seek Wells Fargo governance reforms including

- Separation of the chief executive and chair positions;
- Appointment of a consumer ombudsman or confirmation that such a position exists, with detailed information on the position's authority and role within the organization;
- Development of an anonymous ethics reporting process and whistleblower protection program or confirmation that such a program exists with detailed information on the program and how it operates;
- A review of Wells Fargo's compensation practices; and,
- Consideration of 'clawbacks' for those executives most directly linked to Wells Fargo's deceptive and predatory sales practices.[61]

[59] *Wells Fargo faces 'top-to-bottom' Labor Department review for possible workplace violations*. LA Times. September 27, 2016, http://www.latimes.com/business/la-fi-wells-fargo-overtime-20160927-snap-story.html

[60] *Wells Fargo to Claw Back $41 Million of Chief's Pay Over Scandal*. The New York Times. September 27, 2016. http://www.nytimes.com/2016/09/28/business/dealbook/wells-fargo-john-stumpf-compensation.html?_r=0

[61] California State Treasurer John Chiang Letter to Wells Fargo & Company, September 28, 2016. http://www.treasurer.ca.gov/news/releases/2016/20160928_letter.pdf