Date of Hearing: July 8, 2019

ASSEMBLY COMMITTEE ON BANKING AND FINANCE
Monique Limón, Chair
SB 472 (Caballero) – As Amended May 7, 2019

SENATE VOTE: 35-0

SUBJECT: Earned income access service providers

SUMMARY: Establishes a regulatory framework for earned income access providers.

Specifically, **this bill**:

1) Defines the terms "delivery," "consumer," "earned income," "earned but unpaid income," "earned income access service provider," and "earned income obligor."

    a. Earned income is money that a consumer (i.e., a natural person) has represented, and an earned income access service provider has reasonably determined, have accrued to the benefit of that consumer for services rendered to an earned income obligor.

    b. An earned income obligor is either an employer or another person who is contractually obligated to pay a consumer a sum of money for labor or services provided by that consumer to or on behalf of that other person, as specified.

    c. An earned income access service provider is a person engaged in the business of delivering earned but unpaid income to a consumer in California.

2) Authorizes an earned income access service provider to offer earned income access services in either of the following ways:

    a. Through a contractual arrangement with an earned income obligor in which the provider delivers earned income to the consumer prior to the consumer's payday, and the obligor deducts the amount of the earned income delivered by the provider from the consumers next paycheck. This arrangement is colloquially known as the "direct to business" or "employer-based" model.

    b. Through a contractual arrangement with a consumer in which the provider delivers earned income directly to a consumer and is repaid directly by the consumer. This arrangement is colloquially known as the "direct to consumer" model.

3) Requires earned income access service providers to do all of the following:

    a. Allow a consumer to cancel participation in an earned income access program at any time without incurring a charge for doing so.

    b. Provide each consumer with a document, written in a minimum 12-point font size and in language intended to be understood by a layperson, informing the consumer of his or her rights under the earned income access program, including instructions for how

to cancel participation.

c. Deliver earned income to a consumer via any means mutually agreeable to the consumer and provider and refrain from charging consumers different amounts, based on the manner in which the consumer elects to receive the funds.

d. Provide more than 50% of the amount of a consumer's gross earned but unpaid income as of the date and time of the consumer's request for funds.

e. Charge a consumer more than $14 per monthly pay period for participating in an earned income access service program, an amount that must be prorated for shorter periods (thus, this fee could not exceed $7 per pay period for workers who get paid twice a month). Fees may be charged on a periodic basis, a per delivery basis, or a combination of the two, but may not exceed the $14 per month cap.

f. Provide earned income to a consumer more than three times in a single pay period.

g. Limit the number of pay periods per year during which a consumer may access earned income prior to their payday.

h. Provide in its contract with an obligor that the obligor may not charge a consumer, directly or indirectly, for participating in an earned income access service program.

4) Requires earned income access service providers to maintain a minimum net worth of at least $250,000; a fidelity bond or bonds in an amount not less than $250,000, as specified; and errors and omissions insurance in an amount not less than $250,000, as specified; and clarifies that each of these requirements is independent of one another, and an act taken to satisfy one of these requirements may not be used to satisfy either of the others.

5) Prohibits an earned income access service provider from doing any of the following:

   a. Requiring a consumer to open, maintain, or close a checking account at any particular depository institution, accept direct deposit of his or her wages into any specific depository institution; or sign up for any other product or service, as a condition of offering earned income access services to that consumer.

   b. Trying to debit a consumer's depository institution account after the provider receives notice of a failed payment transfer from that account. Notwithstanding this prohibition, a provider may initiate an additional payment transfer from a consumer's account following a failed attempt, if the subsequent payment transfer is authorized by the consumer.

   c. Initiating a payment transfer from a consumer's account without first notifying that consumer, at least two days before the date of each transfer, of the amount due and the date the transfer will be attempted.

6) Provides that a person who violates the aforementioned rules is subject to a civil suit in a court of competent jurisdiction and to a civil penalty of up to $2,000 per violation.

7) Provides that the delivery of earned but unpaid income to a consumer by an earned income access service provider in accordance with the aforementioned rules does not represent a credit transaction under state law, because the funds provided to the consumer are those that the consumer has already earned. Further provides that the imposition of one or more fees on a consumer who opts to use the services of an earned income access service provider does not represent a violation of Labor Code Section 212, as long as the consumer is informed in writing of his or her right to receive the full amount of his or her wages, without discount, if the consumer waits until his or her regular payday.

EXISTING LAW:

1) Provides for the licensure and regulation by the Commssioner of Business Oversight of money transmitters (Division 1.2, commencing with Section 2000, of the Financial Code), finance lenders and brokers (Division 9, commencing with Section 22000, of the Financial Code), and deferred deposit originators (Division 10, commencing with Section 23000, of the Financial Code).

2) Provides that no person shall issue in payment of wages due, or to become due, or as an advance on wages to be earned any order, check, draft, note, memorandum, or other acknowledgement of indebtedness, unless it is negotiable and payable in cash, on demand, without discount, as specified. (Labor Code Section 212)

FISCAL EFFECT: This bill is keyed nonfiscal. As proposed to be amended, the bill will be keyed fiscal by Legislative Counsel. Fiscal effects of the proposed amendments are unknown.

COMMENTS:

1) PURPOSE

The purpose of this bill is to provide statutory clarity related to services that allow consumers to access earned income prior to their scheduled date of pay. According to the author:

> For years, the legislature has been trying to clamp down on predatory lending, and until recently there has not been a safer alternative to address the very real need of people accessing their money before payday. SB 472 seeks to create statutory clarity so Earned Income Access programs can continue to be a prudent and less costly alternative to payday lending. Earned Income Access is a socially responsible alternative for consumers that simply allows them to access a portion of the wages that they have already earned before their next payday. These programs have been proven to reduce the demand for payday loans, and does so far more cheaply and with less risk for consumers.

2) BACKGROUND

The misalignment of a household's income and expenses is a common factor that leads a consumer to seek out credit. While the consumer's annual income is sufficient to meet expenses over the course of the year, the timing of that income is not always aligned with the timing of expenses within a given month. Consumers with prime credit scores often use revolving credit lines, such as the traditional credit card, to better align the timing of cash outflows with cash inflows. Consumers who do not have access to traditional lines of credit

often turn to alternative financial service providers (e.g., payday lenders, pawn shops, and auto title lenders) for credit products.

According to research by the Financial Health Network, nearly one-third of consumers who use small-dollar credit from alternative financial service providers are seeking to solve the misalignment of their household's cash flow.[1] The most common reason that this type of consumer takes out credit is to pay a utility bill, and more than two-thirds of these consumers take out less than $500, often using a payday loan. In California, a borrower can receive up to $255 from any individual payday lender, which requires repayment of $300 on the borrower's next payday.

In recent years, a dozen or more companies have introduced products into the market that help consumers access their earnings prior to their scheduled payday at significantly lower costs than a payday loan. The industry refers to these products as "earned income access" or "early wage access." These companies, or providers, use technology to integrate with an employer's payroll processing software or to analyze the cash flow going into and out of a consumer's bank account. The former can be described as an employer-based model, while the latter can be described as a direct-to-consumer model.

3) HOW THESE SERVICES WORK

Providers using the employer-based model have contracts with employers that give the provider access to workers' employment data, including attendance, earnings, and withholding information. Workers can elect to access advance services by signing-up, typically online or through a mobile application. When a worker decides to take out an advance, the provider reviews the worker's attendance and wage data to calculate the worker's earned but unpaid wages. After advancing funds to the worker, the provider coordinates either directly with the employer or with the employer's third-party payroll processor to schedule repayment of the advance on the worker's next payday.

Providers using the direct-to-consumer model do not have relationships or contracts with employers, but rather engage directly with consumers, most often via a mobile application. Some direct-to-consumer providers are able to access a consumer's employment information by contracting with a payroll processing company, but it is more common for the provider to rely on information received from a consumer, such as transaction data from a consumer's bank account and location data transmitted by a consumer's mobile phone. In order to facilitate repayment for of advanced funds, direct-to-consumer models rely on an authorization from the consumer to debit the consumer's bank account on an agreed upon date, which is often scheduled on the day of the consumer's next payday.

Fee structures vary across providers. Some providers charge a monthly subscription fee (typically less than $10), while others charge a transaction fee (typically $2 - $5 per access). Fees are often paid by the consumer, although some employers agree to pay a portion or the entire fee. One provider, Earnin, does not directly charge a fee but relies on voluntary "tips" from its user to keep the company financially viable. Providers may also provide additional services bundled with the income advance service, such as monthly budgeting tools, bill pay

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[1] https://finhealthnetwork.org/research/know-your-borrower-the-four-need-cases-of-small-dollar-credit-consumers/

services, and overdraft protection. These additional services are often integrated into the same mobile application that consumers use to facilitate income advances.

Access criteria also vary across providers. Some providers limit the amount of an advance to a percentage of earned but unpaid income. For example, PayActiv, the sponsor of the bill, limits advances to 50% of net pay earned in the pay period, at the time the advance is requested. DailyPay, a different employer-based provider, allows consumers to access up to 100% of their net pay earned, assuming the employee's employer does not set a lower percentage. Other providers place a flat dollar cap on the advance amount, rather than a percentage of earned income; these caps range from $75 to $500. Providers may also limit the number of times a consumer can access advances, which range from a limit of one advance per pay period to some providers that do not limit the number of advances at all.

4) POTENTIAL BENEFITS AND RISKS TO CONSUMERS

There are significant potential benefits to consumers of having access to their earnings before their scheduled payday. Working families experience significant volatility in both their earnings[2] and expenses[3] on a month-to-month basis, which increases the risk that they will encounter a situation where they do not have cash available to meet a necessary expense. In times of misaligned cash flow, people without access to credit cards face a number of more costly options to cope with their financial situation. For example, they can seek out a payday loan that costs $45 to borrow $255 for two weeks and can lead to a cycle of re-borrowing that becomes extremely costly. If a payday loan is not preferable, they may be able to delay discretionary expenditures and hope to avoid a $35 overdraft fee before their next payday. Both of these options are more costly than receiving early access to earned income, which typically costs less than $10.

On the other hand, granting early access to income may expose consumers to financial risk. Under some models, a consumer agrees to repay an advance by authorizing the provider to debit the consumer's checking account. If the consumer does not have sufficient funds to repay the advance on the scheduled date, the consumer's bank will charge the consumer an overdraft fee, an outcome that the consumer was likely trying to avoid when she requested the advance in the first place. Another potential risk is related to overuse or reliance. A consumer who accesses her wages early will have fewer funds available on payday, which may place additional strain on her financial resources in the following pay period and cause her to seek out another advance.

5) WHAT DOES THIS BILL DO

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[2] Working families experience more than a 10% increase or decrease in monthly income in six months of the year. Consumer and Community Development Research Section of the Federal Reserve Board's Division of Consumer and Community Affairs. Report on the Economic Well-Being of U.S. Households in 2015. Board of Governors of the Federal Reserve. 2016. P. 18. Available at: https://www.federalreserve.gov/2015-report-economic-well-being-us-households-201605.pdf

[3] Working families experience swings of 25% or more in monthly expenses. Farrell, D. and Greig, F. Weathering Volatility: Big Data on the Financial Ups and Downs of U.S. Individuals. JPMorgan Chase Institute. 2015. p. 3. Available at: https://www.jpmorganchase.com/corporate/institute/document/54918-jpmc-institute-report2015-aw5.pdf

This bill attempts to accomplish two basic goals: (1) provide statutory clarity about how income advance services are treated under state law and (2) establish basic guardrails intended to protect consumers who use income advance services. This section will generally describe how the bill, as amended in the Senate on May 7, 2019, attempts to achieve those goals and provides a brief discussion about whether the specific provisions achieve the stated goal. Committee staff suggested and the author agreed to extensive amendments that align with these two basic goals. The proposed amendments are detailed in a subsequent section of the analysis.

Statutory Clarity

- "Credit transaction" – This bill states that income advance services are not considered credit transactions under state law. The term "credit transaction" is not defined in the Financial Code and is not a generally understood term. As currently proposed in the bill, this provision does not provide statutory clarity to businesses or consumers on whether income advance services are regulated under current California laws governing financial service providers, including the Money Transmission Act, the California Financing Law, or the Deferred Deposit Transaction Law.

- Definitions – This bill defines "earned income" and "earned income access service provider" and describes the two primary methods by which businesses offer services (i.e., employer-based and direct-to-consumer). As written in the bill, these definitions and descriptions are not adequately inclusive of the variety of business models in the market. It is not clear whether providers using these business models would be subject to a variety of existing laws governing financial service providers, or if they would need to change their business models to fit inside the definitions proposed by the bill in order to comply with state law.

Consumer Protections

- Fee cap – Prohibits a provider from charging a consumer more than $14 per month to access income advances. The proposed fee cap ensures that these services will cost significantly less than a payday loan or bank overdraft fee.

- Earnings advance cap – Stipulates that a provider cannot advance more than 50% of a consumer's gross earned but unpaid income as of the time of the consumer's request. The author's rationale for including this provision is to protect against a consumer accessing all of her earnings early and having no funds available on payday. In theory, this limit provides some protection against the risk of a consumer overusing or becoming reliant on earnings advances. On the other hand, this limit may push a consumer to a more expensive alternative, such as a payday loan, if that consumer needs access to more than 50% of her earnings.

- Right-to-cancel – Ensures that consumers can cancel participation in an income advance program without incurring a penalty to do so.

- Credit reporting – Prohibits a provider from reporting a failure to repay an advance to credit reporting agencies.

6) LACK OF REGULATORY OVERSIGHT

This bill does not place income access providers under the oversight of any state agency. Instead, the bill proposes a number of requirements and restrictions in statute and provides for a private right of action as the enforcement mechanism to incentivize compliance with the law.

In California, the Department of Business Oversight (DBO) is charged with overseeing a wide variety of financial service providers, including banks, credit unions, finance lenders, brokers, money transmitters, student loan servicers, mortgage loan originators, and more. Typically, state law requires these businesses to receive either a charter or a license from DBO to operate. In exchange for the charter or license, a business must comply with specified requirements, restrictions, and prohibitions that are designed to protect consumers and maintain the safety and soundness of the financial system. A businesses must also pay fees to cover DBO's costs related to regulating and enforcing the law.

The industry of earned income access providers is relatively new. Most companies providing these services have been in existence for less than ten years, many of the companies may not be profitable, and there appear to be only a dozen or so companies operating in California. Licensing laws can be expensive, depending on the number of staff required for rulemaking, application processing, and examination and enforcement. Given the relatively small number of companies providing these services, a licensing law may result in a regulatory cost burden that would deter companies from serving California consumers.

Rather than provide no regulatory oversight at all, a compromise approach could provide DBO with sufficient authority to collect information about providers and to investigate complaints from consumers without requiring DBO to conduct routine examinations or enter into rulemaking procedures. Such an approach is discussed in the Amendments section below.

As the Legislature learns more about the viability of the industry and issues of potential harm to consumers, it may decide to pursue a full licensing framework, which would be in accordance with how the state regulates many other financial service providers.

7) DOUBLE-REFERRED

This bill is double-referred to the Assembly Banking and Finance and Assembly Judiciary Committees.

8) AMENDMENTS

Before this bill passed the Senate, many of the providers of income advances had not submitted detailed feedback to the author's office regarding concerns or recommendations related to the bill's language. After this bill passed the Senate, the author's office convened three stakeholder meetings that included all interested stakeholders and also included staff from the Assembly Banking and Finance, Assembly Judiciary, and Senate Banking and Financial Institutions Committees. Based on stakeholder meetings, Committee staff suggested amendments to the bill, and the author has agreed to accept these amendments. Those amendments are summarized below.

a) **Regulatory oversight**

i) Requires providers to register with DBO prior to engaging in the business of providing income advances

ii) Requires providers to submit annual reports with data related to the volume of advances provided, the number of advances per consumer, and the number of consumers affected by failed payment transfers

iii) Requires DBO to track complaints

iv) Authorizes DBO to access a provider's records for the purpose of securing information necessary to administer or enforce the requirements and prohibitions of the division

v) Authorizes DBO to issue desist and refrain orders for violations of the division and issue citations that require a provider to make restitution to a consumer

b) **Sunset date** – The division will become inoperable on January 1, 2023

c) **Additional consumer protections**

i) Requires providers to give a consumer information about filing a complaint with DBO at the time that consumer makes a complaint to the provider

ii) Prohibits a provider from selling, sharing, or disclosing personal information collected for the purpose of providing an income advance

iii) Requires a provider to take best efforts to ensure a consumer has adequate funds in her account before initiating a withdrawal

iv) Requires that income advances must be offered on a non-recourse basis, which means no debt collection activity and no reporting to consumer credit reporting agencies

v) Adjusts bonding and insurance requirements to track with the volume of income advances outstanding, which is intended to provide stronger financial protections in case a provider struggles to meet legal obligations to wronged consumers

d) **Fee cap**

i) Increases the monthly fee cap to $15

ii) Provides flexibility in the case of voluntary "tips," but prohibits a provider from receiving more than $15 per month on average, calculated semi-annually

e) **Earnings advance cap exception** – Permits an exception, twice in each semiannual period, for a worker to access more than the 50% cap on accrued earnings

f) **Technical clean-up**

i) Clarifies that the Money Transmission Act, the California Financing Law, and Deferred Deposit Transaction Law do not apply to providing advances, as specified in the bill

ii) Clarifies that a payroll services provider that is not separately engaged in the business of providing advances is not subject to the division

iii) Clarifies that any money or other consideration paid by a consumer is subject to the monthly fee cap

iv) Clarifies that a provider cannot make more than three advances to a consumer per week

v) Restructures and clarifies definitions to more accurately reflect how services are provided

9) OUTSTANDING ISSUE

As proposed to be amended, this bill assumes that providers advance funds based solely on a worker's earned but unpaid income *from work* (whether as an employee or independent contractor). During a recent stakeholder meeting, the author's office and committee staff learned that at least two providers operating in California may also advance funds based on anticipated income from non-work sources, such as alimony or social security; however, these providers state that non-work sources of income are relatively rare, and they often rely on income from work. The author may decide to refine definitions and structure of the bill in order to accommodate these business models and provide additional protections to consumers who interact with these providers.

REGISTERED SUPPORT / OPPOSITION:

Support

PAYACTIV (Sponsor)

Opposition

National Consumer Law Center

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