Date of Hearing:

ASSEMBLY COMMITTEE ON BANKING AND FINANCE
Monique Limón, Chair
AB 2196 (Gonzalez) – As Amended March 16, 2020

SUBJECT: Pilot Program for Increased Access to Responsible Small Dollar Loans

SUMMARY: Removes the sunset date in the Pilot Program for Increased Access to Responsible Small Dollar Loans, making the program permanently authorized by the state.

Specifically, **this bill**:

1) Repeals the existing sunset date of January 1, 2023, for the Pilot Program for Increased Access to Responsible Small Dollar Loans ("Pilot Program").

2) Removes the requirement for Department of Business Oversight (DBO) to provide a recommendation in the annual report to the Legislature regarding whether the Pilot Program should be extended beyond the specified sunset date.

EXISTING LAW:

1) Until January 1, 2023, authorizes the Pilot Program for Increased Access to Responsible Small Dollar Loans within the California Financing Law (CFL) (Financial Code Sections 22365 et seq. All subsequent references to statute are within the Financial Code.). The following are key rules applied to consumer loans made pursuant to the Pilot:

   a) Permits approved licensees to make a loan with a bona fide principal amount of at least $300, but less than $7,500. Caps interest rates at approximately 36% per annum, depending on the size of the loan (Section 22370(b)).

   b) Provides that a licensee may charge an administrative fee in an amount not to exceed 7% of the principal amount, or $90, whichever is less, on a first loan, and 6% of the principal amount, or $75, whichever is less, on a second or subsequent loan. A licensee may not charge an underwriting fee more than once in any four-month period, and no administrative or underwriting fee may be charged in connection with a loan refinance unless at least eight months have elapsed, as specified (Section 22370(c)).

   c) Requires that loans under the Pilot Program must have a minimum principal amount of $300 upon origination and a term not less than: (i) 90 days for loans whose principal balance is less than $500; (ii) 120 days for loans whose principal balance is at least $500 but less than $1,500; (iii) 180 days for loans whose principal balance is at least $1,500; and (iv) one year for loans whose principal balance is more than $2,500 (Section 22370 (a)).

   d) Requires a licensee to underwrite each loan and states that the licensee shall not make the loan if it determines that the borrower's total monthly debt service payments exceed 50% of the borrower's gross monthly income for loans of $2,500 or less or 36% of the borrower's gross monthly income for loans of more than $2,500, as specified (Section 22370(f)).

2) Authorizes a licensee who participates in the pilot program to use the services of one or more finders, as specified, and defines a "finder" as an entity that, at the finder's physical location for business, brings a licensee and a prospective borrower together for the purpose of negotiating a loan contract (Section 22371).

3) Authorizes a finder to perform one or more of the following services for a licensee at the finder's physical location for business: a) distributing written materials; b) providing written factual information about the loan; c) notifying a prospective borrower of the information needed to complete an application; d) entering information from a prospective borrower into a database; e) assembling credit applications and other materials; f) contacting the licensee to determine the status of a loan application; g) communicating a response regarding underwriting; and h) obtaining the borrower's signature on documents (Section 22372).

4) Authorizes certain licensed or regulated finders to disburse loan proceeds to a borrower and receive loan payments from the borrower (Section 22372).

FISCAL EFFECT: Unknown.

COMMENTS:

1) PURPOSE

According to the author:

> Since the Pilot Program's inception, the program has demonstrated substantial growth and has achieved many of the goals the Legislature sought out to accomplish. According to the 2019 DBO Annual Report of Activity under the Pilot Program, over a three-year period, more than 59 percent of borrowers who took out more than one loan received a higher credit score in the process, with an average increase of 183 points in 2018. Additionally, the annual total principal of loans made between 2016 and 2018 increased 36 percent, from $242 million to $329.8 million, indicating a growing need for the Pilot Program.
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> However, despite demonstrated success during recent years, the Pilot Program is set to expire at the end of 2022. If the program is left to sunset, Californians will be left without access to capital that carry the same level of consumer benefits and protections offered under the Pilot Program.

2) BACKGROUND

The pilot program was created to incentivize more lending activity for loans with principal amounts of less than $2,500. Prior to the existence of the pilot program, lenders were prohibited from offering loans with interest rates above the formula-based interest rate caps of 12-30% provided by the California Financing Law. These rate caps, when applied to relatively small loans, limited the revenue that a lender could earn on such a loan, which resulted in lenders using conservative underwriting standards that limited access to borrowers with damaged credit or limited credit history from accessing these types of loans. In order to attract more lenders to the space, the Legislature created the pilot program in 2010, allowing lenders to charge annual interest rates of up to 36%, plus an origination fee, in exchange for prescribed underwriting and credit reporting requirements.

In 2018, the Legislature passed and Governor Brown signed AB 237 (Gonzalez), Chapter 1016, Statutes of 2018. The bill increased the maximum size of pilot program loans to $7,500 and made additional changes to the program, including a requirement for a lender to conduct a background check on its finders, a requirement for DBO to examine finders for compliance with the law, and expanded reporting requirements related to finders.

The new reporting requirements became operative on January 1, 2019, meaning the first annual report based on the updated program will cover activity during calendar year 2019. Pilot program lenders are required to submit their annual report to DBO by March 15 each year, and DBO typically publishes the Pilot Program report in the summer of each year. As of May 14, 2020, the first Pilot Program report to include the additional information on finders has not been published and will likely not be published prior to this bill being voted on by the Assembly.

3) PILOT PROGRAM DATA

The most recent information about activity under the Pilot Program is found in the 2018 annual report, which was initially published in July 2019 and revised in December 2019.[1] As shown in the table below, the program has seen little growth in the number of participating lenders, but loan volume has grown considerably, likely tied to growth in the number of finder locations.

	2016	2017	2018
Market Structure			
Lenders	14	16	16
Finders	25	33	109
Finder Locations	252	401	616
Loan Volume			
Loan Applications	384,211	533,737	681,470
Approvals	201,494	230,855	299,542
Approval Rate	52%	43%	44%
Principal Amount	$ 242,398,124	$ 258,959,976	$ 329,855,842

In general, the data do not consistently show a difference in outcomes for consumers that borrow directly from a lender compared to consumers that access the lender through a finder. For example, lenders that do not use finders reported a higher proportion of their borrowers who had an increase in their credit scores, but also a higher proportion of borrowers who experienced a delinquency or received a late fee, compared to lenders that use finders. Any individual metric that shows a difference in borrower outcomes could be due to underlying differences in the characteristics of borrowers, rather than differences in how lenders and finders behave.

In addition to differences in underlying borrower characteristics, pilot lenders who entered the market earlier may have located in more ideal geographic locations than pilot lenders who entered the market later. Based on the available data, it is difficult to conclude that one

[1] https://dbo.ca.gov/wp-content/uploads/sites/296/2019/07/2018-RSDL-Pilot-Program_FINAL.pdf

business model is better or worse for consumers than the other or that one business model is more effective in reaching consumers who have limited credit options than the other. For example, lenders that use finders reported serving a higher proportion of Spanish-speaking customers and a higher proportion of unbanked customers than lenders that do not use finders, but lenders that use finders also reported a lower proportion of lending in low- and moderate-income census tracts than lenders that do not use finders.

4) RECOMMENDATIONS FROM DBO

Existing law requires DBO to include in the annual report the department's recommendations for improving the program and recommendations for whether the program should be continued after January 1, 2023. In the most recent annual report, the DBO provides the following:

> The current version of the Small Dollar Pilot Program became operational January 1, 2019. The DBO recommends policymakers give the program more time to work before making changes. Recommendations for improvements, at this time, would be premature.
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> The changes brought by previous Pilot Program versions doubled the number of lenders participating in the program and near [sic] than double the number of borrowers applying for loans. However, the revisions did not significantly impact the volume of lending activity. The number of Pilot Program loans made is approximately 50 percent of the applications taken. The DBO will consult with licensees, consumer advocates and policymakers to explore ways to increase participation in the Pilot Program by both lenders and borrowers.

5) AMENDMENTS

Based on available data, the Pilot Program appears to provide credit access to some borrowers at more affordable rates than those borrowers would receive from other lenders and to some borrowers who would not be approved for credit by other lenders at all. Despite these apparent positive outcomes, there are two primary reasons the Legislature may want to delay a decision about making the Pilot Program permanent based on the existing design of the program.

First, the Legislature has not yet received an annual report based on the activity that occurred after the most recent changes to the program became operational on January 1, 2019. In theory, the Legislature enacted the annual reporting requirement in order to inform future decisions about whether to amend, renew, or end the program. Making the program permanent prior to analyzing relevant data would deprive the Legislature of information that could be helpful in designing improvements to the program to incentivize broader participation in the program by lenders and generate better outcomes for borrowers.

Second, the recommendations from DBO discussed in the preceding section include a commitment from the department to "consult with licensees, consumer advocates and policymakers to explore ways to increase participation in the Pilot Program by both lenders and borrowers." The Legislature may benefit from permitting DBO more time to evaluate how recent changes to the program have affected activity. In addition to the recent changes to the program, AB 539 (Limón), Chapter 708, Statutes of 2019, went into effect on January 1,

2020. AB 539 limited interest rates on CFL loans of $2,500 to $10,000 made *outside* of the Pilot Program to approximately 36%. The new limitations on interest rates for these loans could have an effect on how the Legislature considers changes to the Pilot Program, though the current economic crisis due to COVID-19 will likely confound the analysis of the effects of AB 539 on the market for small-dollar loans.

Rather than make the program permanent, the Legislature may elect to extend the sunset date. An extension will send a message of confidence to lenders – both those currently approved to participate and potential applicants – and the lenders' investors that the program is not going away. An extension will also send a message to all stakeholders that the program may continue to be refined as additional annual reports provide more information about the program and how it may be improved for borrowers and lenders.

Recommended amendments

Restore the provisions that refer to the sunset date and amend the sunset date to January 1, 2028.

6) ARGUMENTS IN SUPPORT

The Pew Charitable Trusts writes in support of the bill, stating the organization's extensive research of small-dollar credit over the past decade. Pew identifies the problematic structure of payday loans in California and touts the key benefits of the Pilot Program, including lower finance charges, longer repayment terms, and the principal reduction structure of a Pilot loan.

Aura, a relatively large Pilot lender that uses finders, and a coalition of business and community groups writes that, "the Pilot Program is set to expire at the end of 2022. If the program were to sunset, un- and under-banked Californians with no or limited credit histories would be left without access to consumer loans with strict consumer protections and the ability to build credit."

7) ARGUMENTS IN OPPOSITION

The California Reinvestment Coalition and Center for Responsible Lending write:

> We oppose the extension of the pilot for the following reasons 1) We believe that the length of the program as is will allow the State to collect necessary data on how the program is working and assess if its met the intended goals of providing a non-extractive product. 2) In the time of an unprecedented public health and economic crisis caused by the COVID19 pandemic, we strongly believe it is a mistake to divert necessary resources to extend the pilot program now when there are more than two years left before the pilot expires. 3) In this time of crisis, in which more than 40% of families earning less than $40,000 a year reported a job loss, it is imperative that we shore up income supports for California families, the pilot program with APRs up to 78% places an economic burden on families. We have proposed a 15% rate cap on all small dollar loans not covered by AB 539 in order to ensure that income strapped families are not burdened with loans.

REGISTERED SUPPORT / OPPOSITION:

Support

Aura
California Cattlemen's Association
California Hispanic Chamber of Commerce
Dolex Dollar Express, INC
Farmworker Institute of Education & Leadership Development
Hispanic Foundation of Silicon Valley
Insikt, INC.
Kern Schools Federal Credit Union
Listo Unlimited INC.
New America Alliance
Pew Charitable Trusts; the
The Pew Charitable Trusts
United Food and Commercial Workers, Western States Council

Oppose

California Financial Services Association
California Reinvestment Coalition
Center for Responsible Lending
The Greenlining Institute

Other

Lendmark Financial Services
Oportun

Analysis Prepared by: Michael Burdick / B. & F. / (916) 319-3081