Date of Hearing: April 18, 2022

ASSEMBLY COMMITTEE ON BANKING AND FINANCE
Timothy Grayson, Chair
AB 2540 (Berman) – As Introduced February 17, 2022

SUBJECT: Qualifying accounts for direct deposit of publicly administered funds

SUMMARY: Allows a prepaid account or account offered by an entity other than an insured financial depository financial institution (qualifying account) to be eligible for direct deposit of certain public benefit payments even if the account offers a credit or overdraft feature that contains a voluntary fee. Specifically, **this bill**:

1) States that the current requirements prohibiting a qualifying account's use of an overdraft or credit feature that charges fees, charges, or costs does not affect a credit or overdraft feature that contains a voluntary charge, fee, or cost, but only if the availability of that feature is neither enhanced nor demised in any way by the accountholder's exercise or non-exercise of the voluntary fee, charge, or cost.

2) Applies the change in "qualifying account" described in 1) to the direct deposit standards for child support, disability, public assistance, and unemployment insurance (UI) payments.

EXISTING STATE LAW:

1) Requires that if child support payments are deposited directly into an account of the recipient's choice, the funds only be deposited into a "qualifying account," defined as a demand deposit or savings account at an insured financial institution in the name of the person entitled to the receipt of child support payments, or a prepaid account or direct deposit or savings account offered through entity other than an insured financial institution that meets specific criteria (Family Code Section 17325).

2) Requires that if UI payments are deposited directly into an account of the recipient's choice, the funds can only be deposited into a "qualifying account" defined as a demand deposit or savings account at an insured financial institution in the name of the person entitled to the receipt of public assistance, or a prepaid account or direct deposit or savings account offered through entity other than an insured financial institution that meets specific criteria. (UI Code Section 1339.1).

3) Requires that any person entitled to the receipt of public assistance payments may authorize payment to be directly deposited into a "qualifying account" at a financial institution of their choice. A "qualifying account" is defined as a demand deposit or savings account at an insured financial institution in the name of the person entitled to the receipt of public assistance, or a prepaid account or direct deposit or savings account offered through entity other than an insured financial institution that meets specific criteria (Welfare and Institutions Code Section 11006.2).

EXISTING FEDERAL LAW:

1) Establishes the Electronic Funds Transfer Act (EFTA) for the purpose of providing a basic framework establishing the rights, liabilities, and responsibilities of participants in electronic fund and remittance transfer systems. (15 U.S.C. Sec. 1693 et seq.)

FISCAL EFFECT: Unknown. This bill is keyed Fiscal by Legislative Counsel.

COMMENTS:

1) **Purpose.**

According to the author:

> Over the past decade, California has taken necessary steps to ensure that the recipients of public benefits are protected from predatory and anti-consumer practices. SB 497 from this past year was the latest measure to crack down on attempts to circumvent our laws. Those changes were appropriate and necessary. However, without further clarification of truly voluntary tipping, consumers could lose an option and be prohibited from utilizing non-bank accounts that maintain critical consumer protections. AB 2540 would provide greater clarity while still meeting the spirit and intent of the law.

2) **Some recent history**

In 2013 and 2014, the Legislature enacted new rules related to the direct deposit of certain government-established cash transfers to address issues related to prepaid, reloadable cards that were the subject of significant controversy. At the time, many card users complained about the lack of protection for theft recovery and fees. Thus, AB 1280 (Pérez), Chapter 557, Statutes of 2013 and AB 2241 (Pérez), Chapter 189, Statutes of 2014, established that child support payments, cash assistance, and UI payments may only be directly deposited into a "qualifying account." A qualifying demand deposit or savings account must be held at an insured financial institution, and a qualifying prepaid card account, used mainly when funds cannot be directly deposited into a beneficiary's account at a financial institution, must be (1) held at an insured financial institution, (2) not be attached to any credit or overdraft feature, (3) meet certain federal guidelines for pass-through insurance, and (4) meet all EFTA requirements.

In 2021, the Legislature once again revisited this issue and passed SB 497 (Limon) to place additional standards around the use of non-bank accounts. The stated goal of SB 497 was to prevent nonbank prepaid card companies from evading California and federal laws by relabeling their "prepaid cards" as "debit cards" in order to charge overdraft fees.
SB 497 achieved this by modifying the definition of "qualifying account" a demand deposit or savings account offered through an entity *other* than an insured depository financial institution could be eligible for direct deposit if it met the existing standards for a prepaid account. If this account has an overdraft or credit feature, then the feature cannot have a fee, charge, or cost, whether direct, required or voluntary or involuntary.

3) **Tips and voluntary charges**

AB 2540 allows a nonbank deposit or savings account with a voluntary tip option as part of its overdraft feature to be eligible for direct deposit of certain public benefits. At the moment, this bill most clearly accommodates Chime, whose SpotMe product allows for up to $200 in free overdraft but asks for a tip once the accountholder's account balance returns to a positive amount. Chime describes the SpotMe tip feature as follows:

> When your SpotMe negative balance is repaid, we'll give you the option to leave us an optional tip to pay it forward. Whether or not you tip won't affect your SpotMe eligibility. SpotMe is a fee-free service, and friendly tips from our community help it stay that way! [1]

In response to a request from committee staff, Chime provided summary data about how accountholders utilize SpotMe's tip function. In the last 12 months, 20% of users who used the overdraft feature left a tip, and the average tip was $5.05.

While Chime's SpotMe account is the most relevant financial product affected by this bill, voluntary tips have increasingly become a revenue source for emerging financial technology companies and nonbank products and services. These voluntary payments have been the source of controversy and debate. On the one hand, consumers do not necessarily need to pay anything to receive the promised service, which can make the product or service cheaper for the consumer. On the other hand, a profit-motivated company is unlikely to allow for totally voluntary customer payments unless it benefits them in some way, either by generating revenue or by bringing customers into the company's larger ecosystem. As is often the case with many emerging technologies that offer a far cheaper option for the consumer than what is offered elsewhere, the instinct of a wary consumer is to ask, "what is the catch?"

Consumer advocates have also been vocal in their suspicion of voluntary tips. In a letter to the Department of Financial Protection and Innovation (DFPI) about the regulation of earned wage access providers (some of whom use a tip model), the National Consumer Law Center (NCLC), who opposes this bill, includes the following detailed critique of the tip model:

> The use of purportedly voluntary "tips" is particularly deceptive and evasive. This is not a model that DFPI should in any way condone or enable. There are several problems with the "tips" model. While the tips are purportedly voluntary, companies can employ strategies to make it difficult not to tip or to make the consumer feel compelled to tip. These range from adding a default tip that must be removed each time, to different user interfaces sending psychological signals, to disingenuous statements about how the tips support a "community" rather than a large company or wealthy hedge fund, to the outright denial or reduction of future credit if the consumer does not tip enough. When caught, companies may change their policies, but these for-profit enterprises with investors who need a significant return on investment will not put up with a lot of free-riding users. DFPI cannot be expected to constantly monitor the subtle and not so subtle back-end ways that companies will make sure that the vast majority of their borrowers tip. Moreover, even without any manipulations, many consumers are likely to feel compelled to tip because they believe that they will be treated differently or might be cut off if they do not. The tipping model takes advantage of consumers' lack of awareness of how the tips add up, and how the price easily gets into the territory

[1] https://www.chime.com/spotme/, Accessed on 3/19/2022

of payday loan pricing. The supposedly voluntary nature of the tips makes it easier to get sucked into a cycle of debt. [2]

4) **Regular bank accounts can still be used.**

AB 2540 focuses on one type of "qualifying account" for direct deposit of public benefits (nonbank or prepaid account), but does not make changes to the standards around traditional bank accounts. The law's restrictions on overdraft fees apply only to nonbank accounts, so consumers who use accounts offered by an insured depository financial institution may face significant overdraft fees. According to BankRate, in 2021 the average overdraft fee nationally was $33.58, which is higher than the average tip provided to Chime for its overdraft feature.[3]

There are some hopeful indications that financial institutions are moving away from overdraft fees. Earlier this year, many of the largest commercial banks announced efforts to either reduce overdraft fees or to improve overdraft protections and to give consumers more flexibility. For example, Bank of America announced in January 2022 that it would reduce its overdraft fee from $35 to $10 and Wells Fargo announced additional policies to give accountholders more time and ability to cover an overdraft before a fee is charged. And, in addition to these larger financial institutions, banks participating in the BankOn Program provide accounts without any overdraft fees.[4] Thus, while overdraft fees remain common, consumers now have a number of options to open a low-cost bank account.

5) **Opposition**

A coalition of consumer groups, including the Citizens for Responsible Lending (CRL) and the National Consumer Law Center (NCLC) oppose AB 2540 unless amended, noting the following:

> Companies have ways of pushing people into tipping by inserting a default tip; making it difficult to undo defaults; claiming that tips go to support "the community" or charitable causes; and taking advantage of the belief that access to credit will be cut off if they do not tip. It is impossible to police the myriad of ways in which companies that depend on tips will collect them. Moreover, calling a fee a "tip" or claiming that it is "voluntary" does not lessen the impact on families who need each cent.

Opponents request a set of amendments that do the following for nonbank accounts with a tip feature:

a) Prohibit any tips added by default;
b) Require an immediate refund if any tips are paid by recipients of unemployment benefits, public benefits recipients, or parents receiving state-collected child support;
c) Add a private right of action to ensure that the law can be enforced.

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[2] https://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/CRL_CA_DFPI_EWA_Comments.pdf
[3] https://www.bankrate.com/banking/checking/checking-account-survey/
[4] See https://joinbankon.org/ to see a list of participating institutions.

6) **Signifcant concerns**

Furthermore, the Consumer Federation of California (CFC), a nonprofit organization that adovcates for consumer rights, has submitted a letter to the committee that cites significant concerns with AB 2540. The letter states:

> CFC believes there is little reason for consumers to tip an entity for not charging overdraft fees, especially since they are prohibited from charging these fees by law. CFC is concerned with so-called "fee creep," where additional unnecessary fees are tacked on to services, usually without calling them "fees". The financial services industry has been particularly aggressive in attempting to augment their revenues by convincing, often with the help of behavioral economists and others refining their algorithms, that consumers should somehow feel grateful that they got a product or service they were supposed to get!

7) **Next steps and recommended amendments**

AB 2540 wades into the current national debate over the use of voluntary tips in consumer financial services. While it is a tailored bill meant to apply to a narrow set of circumstances, this bill could also serve as a symbolic endorsement of the tip model, especially since this bill is specific to the types of accounts that vulnerable Californians can use to receive certain safety net benefits.

At the same time, the committee may wish to be careful in cutting off access to potentially affordable options. This is not an easy balance to strike, and some nonbank accounts, even with their drawbacks, can be a more affordable option for a low-income consumer who is vulnerable to falling into a cycle of overdraft that leaves them even worse off.

The committee recommends the following amendments to the relevant sections of the bill affecting child support payments, unemployment benefits, disability benefits, and public assistance:

> Nothing in subclause (I) affects a credit or overdraft feature that contains a voluntary fee, charge, or cost, but only if ~~the availability or provisions of the credit or overdraft feature to an accountholder are neither enhanced nor diminished in any way by the accountholder's exercise or nonexercise of the voluntary fee, charge, or cost.~~ *all of the following are met:*
>
> *(ia) The availability or provisions of the credit or overdraft feature to an accountholder are neither enhanced nor diminished in any way by the accountholder's exercise or nonexercise of the voluntary fee, charge, or cost.*
>
> *(ib) The default amount, if any, of the voluntary fee, charge, or cost is $0.*
>
> *(ic) The voluntary fee, charge, or cost paid can be refunded at the request of the consumer.*
>
> *(id) Prior to the exercise or nonexercise of the voluntary fee, charge, or cost, the consumer is made aware of features described in (ia) and (ic) through a clear and conspicuous disclosure.*

REGISTERED SUPPORT / OPPOSITION:

Support

Chime Financial, Inc

Oppose Unless Amended

Asian Law Alliance
Bet Tzedek Legal Services
California Asset Building Coalition
California Low-income Consumer Coalition
California Reinvestment Coalition
Center for Responsible Lending
City and County of San Francisco - Office of Financial Empowerment
Faith Action for All
Mental Health Advocacy Services
National Consumer Law Center, Inc.
National Employment Law Project
Public Law Center

Other

Consumer Federation of California

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