Date of Hearing: April 25, 2022

ASSEMBLY COMMITTEE ON BANKING AND FINANCE
Timothy Grayson, Chair
AB 2839 (Villapudua) – As Amended April 18, 2022

SUBJECT: California Financing Law: Pilot Program for Increased Access to Responsible Small Dollar Loans: monthly maintenance fees

SUMMARY: Authorizes a lender making a loan under the Pilot Program for Increased Access to Responsible Small Dollar Loans (Pilot Program) to contract for and receive a monthly maintenance fee of up to $40 on loans between $500 and $2500.

Specifically, **this bill**:

1) Authorizes a licensed lender approved by the Department of Financial Protection and Innovation (DFPI) commission to participate in the Pilot Program to contract for and receive a monthly maintenance fee for a loan of a principal amount that is at least $500 but not more than $2,500. The monthly maintenance fee cannot exceed $40 and may not be added to the loan balance upon which interest is charged.

2) Authorizes DFPI to annually adjust the maintenance fee for inflation based on the California Consumer Price Index as compiled by the Department of Industrial Relations.

3) Requires DFPI to make available on its internet website a list of approved credit education program and seminar providers.

EXISTING LAW:

1) The California Financing Law (Fin. Code Sec. 22000 et seq., known as CFL) requires licensing and regulation of finance lenders and brokers making and brokering consumer and commercial loans, except as specified; prohibits misrepresentations, fraud, and deceptive acts in connection with making and brokering of loans; and provides administrative, civil (injunction and ancillary relief), and criminal remedies for violations of the law.

2) CFL licensees who make consumer loans under $2,500 are capped at interest rates which range from 12% to 30% per year, depending on the unpaid balance of the loan (Financial Code Sections 22303 and 22304). Administrative fees are capped at the lesser of 5% of the principal amount of the loan or $50 (Financial Code Section 22305).

3) The Fair Access to Credit Act authorizes a finance lender, with respect to a loan of a bona fide principal amount of $2,500 or more but less than $10,000, to contract for or to receive charges not exceeding an annual simple interest rate of 36% plus the Federal Funds Rate. (Fin. Code Sec. 22304.5).

4) As an alternative to the rules summarized above, until January 1, 2028, for consumer loans up to $7,500, current law authorizes the Pilot Program. (Financial Code Section 22365 et seq.) Licensed finance lenders accepted to participate in the Pilot Program are allowed to charge different interest rates, administrative fees, and delinquency fees than lenders that are not participating in the Pilot Program. Additionally, Pilot program lenders are allowed to use

finders to help originate loans. They are required to adhere to certain additional underwriting, borrower notification, and annual reporting requirements, and are required to comply with all other provisions of the CFL.

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

COMMENTS:

1) **Recent trends in consumer lending activity.**

The COVID-19 pandemic led to a sharp decrease in consumer lending in California and across the nation. From 2019 to 2020, the number of payday loans made in California declined by 40%, and the number of consumer loans, including installment loans, made by CFL licensees declined by 41.1%.[1]

These trends are not unique to California. A 2021 Bloomberg Law review of national payday lending trends found that payday lending in 2020 in Alabama, Indiana, Michigan, North Dakota, Washington, Kentucky, and Wisconsin dipped between 40% and 60% of 2019 levels.[2]

The primary reason for this decline is the state and federal response to the pandemic and its immediate economic impact. As the DFPI noted in a recent report, distribution of stimulus checks and loan forbearance policies, among other policy interventions, reduced demand for high-cost consumer financial services.

Another possible driver of the drop in consumer lending is consumers turning to different types of financial services to help make ends meet. In the last few years, numerous alternative financial products have emerged that meet some of the financial needs of consumers for less cost. Examples of such products include:

- Buy Now, Pay Later (BNPL) products, which allow a customer to pay for a purchase in equal installments for a fee. While BNPL products have been the subject of criticism and concerns from consumer groups, they are generally more affordable for consumers compared to installment loans.[3] The BNPL market has grown dramatically in volume and has become a larger percentage of DFPI's portfolio under CFL, representing 91% of all originated consumer loans in 2020.

- Earned wage access (EWA) services, which provide employees access to their net earned pay in advance of their designated payday. EWA providers charge a fee that is often

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[1] Each year DFPI publishes data on trends in its licensing programs. See the 2020 report for the payday industry here: https://dfpi.ca.gov/wp-content/uploads/sites/337/2021/07/DFPI_AnnualReport_CDDTL-2020.pdf and the 2020 report for CFL here: https://dfpi.ca.gov/wp-content/uploads/sites/337/2021/10/2020-CFL-Aggregated-Annual-Report.pdf. Note that the cited figure for CFL consumer loans excludes Buy Now, Pay Later products.
[2] Evan Weinberger, "Payday Lenders Prepare for Less Risky Post-Pandemic Borrowing," Bloomberg News (August 16, 2021), available at https://news.bloomberglaw.com/banking-law/payday-lenders-prepare-for-less-risky-post-pandemic-borrowing.
[3] The bulk of BNPL consumer loans in latest DFPI report had an APR of less than $14.99%

lower than payday loans, and use of EWA has grown significantly, with the number of uses nationwide growing from 18.6 million in 2018 to 56 million in 2020.[4]

Some industry stakeholders have also pointed to California's regulatory and policy environment as a reason why consumer lending in California has declined, reflecting a reduced *supply* of these types of loans rather than a reduced demand for them. For example, AB 539 (Limon), Chapter 708, Statutes of 2019, amended the CFL to cap the interest rate (at 36% plus the applicable federal funds rate) for installment loans between $2,500 and $10,000. AB 539 aimed to promote affordable and accessible credit by protecting borrowers from the predatory practices of high-cost lenders, and supporters in particular focused on the prevalence of loans with APRs that exceeded 100%. At the time of AB 539's passage, the bill's opponents contended that the rate cap would force lenders to leave the California market or lead them to tighten underwriting standards, thereby excluding potential borrowers with poor credit histories and limiting lending options for those who most need loans.

AB 539 has been in effect for two years, but the COVID-19 pandemic and the emergence of alternative financial products make it difficult to assess the bill's full impact. One clear effect of AB 539 has been the near eradication of loans with APR of 100% or more. Between 2019 and 2020, the number of such loans decreased by 99.9%, a sign that it has delivered on the goal of eliminating some of the more egregious examples of high-cost consumer loans.

2) **What is the Pilot Program?**

The Pilot Program was originally created in 2010 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 CFL. These rate caps, when applied to relatively small loans, limited the revenue a lender could earn on such a loan, which resulted in lenders using conservative underwriting standards that limited the ability for borrowers with damaged credit or limited credit history to access these types of loans. In order to attract more lenders to the space, the Legislature created the pilot program, allowing lenders to charge annual interest rates of up to 36%, plus an origination fee, in exchange for prescribed underwriting and credit reporting requirements.

Since its creation, the Legislature has regularly modified the Pilot Program to extend the program and grow the number of participating lenders. Most recently, AB 237 (Gonzalez), Chapter 1016, Statutes of 2018, increased the maximum dollar amount of loans to $7,500 and AB 2196 (Gonzalez), Chapter 174, Statues of 2020, extended the Pilot Program's sunset to January 1, 2028.

In its present-day form, the Pilot Program has a number of distinct features compared to the rest of the CFL. First, lenders may use "finders," which are individuals or companies helping to bring a licensee and a prospective borrower together for the purpose of negotiating a loan contract. Second, Pilot Program lenders are subject to different interest rate caps, loans terms, and fee structures compared to other CFL lenders. While Pilot Program lenders can charge

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[4] Evan Weinberger, "Earned-Wage Access Products Face Fresh Scutiny from CFPB, States," Bloomberg Law (February 3, 2022), available at https://news.bloomberglaw.com/banking-law/earned-wage-access-products-face-fresh-scrutiny-from-cfpb-states.

higher interest rates on loan amounts of up to $2,499, the allowable interest rates are actually lower for loans between $2,500 and $7,499 (32%) compared to the CFL (36% plus the federal funds rate), as amended by AB 539.

Finally, the Pilot Program includes a number of consumer-oriented features. For all loan amounts, a borrower must report payments to a major credit bureau, and lenders must engage in underwriting so that the loan does not exceed a 50% debt-to-income ratio for loans up to $2,500 and 36% debt-to-income ratio on loans between $2,500 and $7,499.

3) **Recent trends in Pilot Program lending.**

Despite the Legislature regularly revisiting and modifying the Pilot Program, a small number of lenders participate. In 2020, there were just 18 approved participants. And like other consumer lending, Pilot Program lending declined from 2019 to 2020. Importantly, Aura Financial LLC, one of the biggest lenders who represented 40% of pilot loans in 2019, declared bankruptcy in 2020, leading to a significant reduction in overall Pilot Program activity. DFPI estimates that the missing Aura data represents about 28% of the decrease in the number of loans made in this period, while the remaining 72% can be explained by a general decrease in Pilot Program lending activity.

The Pilot Program also typically serves lower-income households. In 2020, approximately 65% of Pilot Program loans were to borrowers with annual incomes between $20,000 and $44,999. In 2020, 32% of borrowers used a Pilot Program loan to purchase a good or service other than a car and another 20% used the loan to pay bills.

The below shows the distribution of Pilot Program loans in 2020, though this data is incomplete because it does not include the loans made by Aura prior its bankruptcy.

Number of Loans by Pilot Program Lenders, Excluding Aura, by Loan Size and APR, 2020						
APR	**$300 to $499**	**$500 to $999**	**$1,000 to $1,499**	**$1,500 to $2,499**	**$2,500 to $4,999**	**$5,000 to 7,499**
Up to 14.99%	0	1	13	0	0	0
15% - 19.99%	0	2	0	0	0	0
20% to 24.99%	1	107	15	21	0	0
25% to 29.99%	0	14	10	55	0	0
30% to 34.99%	10	1,068	274	742	7	0
35% to 39.99%	1,644	23,228	7,792	13,053	57	4
40% to 49.99%	1	8,836	6,072	8,217	0	0
50% or more	2,874	17,775	2,883	2	0	0
Total # of Loans	**4,530**	**51,031**	**17,059**	**22,090**	**64**	**4**

Notably, the Pilot Program is essentially defunct at the $2,500-and-above level. This is likely because of two factors: Aura's bankruptcy and a lower allowable interest rate compared to the CFL, as amended by AB 539.

4) **What does AB 2839 do?**

AB 2839 allows for a monthly maintenance fee of up to $40 for loans between $500 and $2,500. This fee is not part of the loan but is instead a monthly charge that the consumer pays for however many months the borrower makes payments. This fee is *in addition* to the existing origination fee, which is of the lesser of 7% or $90 on the first loan made to the borrower (and then 6% or $75 on the second loan).

AB 2839, as written, would lead to significant new costs for borrowers. For example, a $500 pilot loan with a 6-month term could result in up to $240 in additional fees for the borrower. The below table shows the possible impact of AB 2839's new fee consumer costs, as calculated as an effective APR.

Estimated Impact of $40 Monthly Maintenance Fee on APR[5]			
Loan Amount	**Term (Months)**	**Pilot Program**	**AB 2839**
$500	6	62.8%	213.7%
$1,000	6	58.6%	137.2%
$2,499	12	39.4%	71.0%

Supporters of this bill contend that a monthly maintenance fee would encourage lenders to participate in the Pilot Program, thereby increasing the availability of loans for borrowers who may otherwise have difficulty qualifying for these types of loans. In theory, such a monthly fee would change the risk calculation for lenders and allow them to loosen underwriting standards for this market of potential borrowers.

5) **Support.**

A number of lenders write in support of AB 2839, arguing that it would increase access to credit by boosting lender participation in the Pilot Program. For example, the California Financial Services Providers (CFSP) writes in support, noting:

> Currently, millions of Americans fall below the "prime" lending category, lacking the necessary credit history to secure a loan in the traditional credit market. In the absence of small dollar loans, a consumer may turn to online loans, tribal loans, checking account overdrafts, auto title loans, pawn shops, loans from friends and family, and paying bills late. Not all these alternatives are regulated by California regulators.

6) **Opposition.**

[5] This illustrative table makes a number of assumptions. First, it is assumed the borrower pays on time and does not need to pay late fees. Second, it is assumed the monthly maintenance fee is a monthly charge outside the loan, as specified in AB 2839. Third, it is assumed the administrative fee reduces the overall loan amount at the origination of the loan, which affects the APR. The APR figure is used to make easier comparisons by loan amounts, though an APR estimate may not always be appropriate for smaller loans or shorter-term loans.

The Californians for Economic Justice coalition, which is a coalition of nonprofit community and faith-based organizations, oppose AB 2839, citing the high costs for consumers:

> While we appreciate efforts to increase access to well-priced credit for Californians who face systemic barriers in accessing beneficial financial products and services, this bill would not accomplish this objective. It would instead harm individuals seeking loans under the small dollar pilot program by saddling them with high-cost debt, without offering any substantive improvements to the program. As Californians enter another year of financial uncertainty in the on-going COVID-19 pandemic, we must ensure that lenders cannot take advantage of our vulnerable communities.

REGISTERED SUPPORT / OPPOSITION:

Support

Populus Financial Group (including ACE Cash Express)
California Financial Service Providers
Cashback Loans
Check Agencies of California
Check Cashiers of Southern California
Community Choice Financial
Continental Currency Services, Inc.
Curo Financial Technologies Corp
Purpose Financial
Su Casa De Cambio Cesar Chavez, Inc.

Oppose

California Low-income Consumer Coalition
California Reinvestment Coalition
Californians for Economic Justice
Cameo - California Association for Micro Enterprise Opportunity
Center for Responsible Lending
City and County of San Francisco - Office of Financial Empowerment
Consumer Federation of California
Consumers for Auto Reliability and Safety
Dolores Huerta Foundation
East Bay Community Law Center
Greenlining Institute
Indivisible South Bay LA
Jewish Center for Justice
LULAC California
Mission Asset Fund
National Consumer Law Center
Public Counsel
Public Law Center

Reinvent South Stockton Coalition
Western Center on Law & Poverty

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