

Date of Hearing: April 28, 2014

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Roger Dickinson, Chair

AB 1927 (Frazier) – As Amended: April 10, 2014

**AS PROPOSED TO BE AMENDED**

SUBJECT: Student financial aid: debit cards.

SUMMARY: Specifies the creation of policies concerning the issuance of financial aid via debit cards. Specifically, this bill:

- 1) Requires the Board of Governors of the California Community Colleges and the Trustees of the California State University and requests the Regents of the University of California as well as the governing bodies of private institutions (henceforth be referred to as "educational institutions") to adopt policies relating to the disbursement of financial aid via debit cards, prepaid, or preloaded card (All further references will be to "debit cards").
- 2) Specifies that the aforementioned policies should be used for negotiating contracts between educational institutions and financial institutions.
- 3) Provides that the policies adopted shall be consistent with federal law, and ensure that contracts between educational institutions and banks or other financial institutions to disburse financial aid onto debit cards shall meet the following standards:
  - a) Prohibit revenue sharing between educational institutions and banks or other financial institutions;
  - b) Prohibit the sale or sharing of private information that the student or the educational institution provides the bank or other financial institution;
  - c) Prohibit the bank or other financial institution from imposing unreasonable fees, including a point of sale transaction fee on a student for the use of the debit card;
  - d) Provide that if the card is cobranded the student shall receive a disclosure that the card is not endorsed by the educational institution;
  - e) Require a disclosure of all fees associated with the debit card;
  - f) Ensure that the student does not incur any cost in opening the account or initially receiving the debit card;
  - g) Ensure that the student has convenient access to a branch office of the bank or an automated teller machine (ATM) of the bank in which the account was opened or of another bank, so that the student does not incur any cost in making withdrawals from that office or those ATMs;
  - h) The branch office or ATMs must be located on the educational institution's campus, in an institutionally owned or operated facility, or immediately adjacent to and accessible from

the campus;

- i) Ensure that the debit card can be widely used;
- j) Not market or portray the account or debit card, prepaid card, or preloaded card as a credit card or credit instrument, or subsequently convert the account or debit card to a credit card or credit instrument; and,
- k) Disclose to students the benefits and responsibilities of all options of financial aid disbursement that are offered by the educational institution.

EXISTING FEDERAL LAW

- 1) Pursuant to 30 C.F.R., Section 668.164, provides that an educational institution may establish a policy requiring its students to provide bank account information or open an account at a bank of their choosing, as long as this policy does not delay the disbursement of specified federal loan funds to students. Requires institutions that open bank accounts on students' or parents' behalfs, establish a process that students or parents can follow to open a bank account, or assist students or parents in opening accounts to do all of the following:
  - a) Obtain written consent from the student or parent to open the account;
  - b) Inform the student or parent of the terms and conditions associated with accepting and using the account, before opening it;
  - c) Refrain from making any claims against the funds in the account without the written permission of the student or parent, except to correct an error in transferring the funds;
  - d) Ensure that the student or parent does not incur any cost to open the account or initially receive any type of debit card, stored-value card, or other type of ATM card, or similar transaction device used to access the funds in that account;
  - e) Ensure that the student has convenient access to a branch office of the bank or an ATM of the bank in which the account was opened (or an ATM of another bank), so that the student does not incur any cost to make cash withdrawals from that office or those ATMs. This branch office or these ATMs must be located on the institution's campus, in institutionally-owned or operated facilities, or immediately adjacent to and accessible from the campus;
  - f) Ensure that the debit card, or other device, can be widely used (e.g., the institution may not limit the use of the card or device to particular vendors); and
  - g) Not market or portray the account, card, or device as a credit card or credit instrument, or subsequently convert the account, card, or device to a credit card or credit instrument;
- 2) Allows schools to contract with servicers for the administration of any aspect of the school's participation in Title IV programs and specifies that a school may accept the standard contract terms and conditions in a servicer's proposal for delivering credit balances or negotiate the terms

and conditions to meet the specific needs of the school or its students (34 CFR § 668.25).

### EXISTING STATE LAW

- 1) Defines the term "debit card" as an accepted card or other means of access to a debit cardholder's account that may be used to initiate electronic funds transfers and may be used without unique identifying information such as a personal identification number to initiate access to the debit cardholder's account (Civil Code [CIV] § 1748.30).
- 2) Limits a debit cardholder's liability for unauthorized use of a debit card (CIV § 1748.31).
- 3) Provides for a variety of student financial aid programs including the Cal Grant programs and the CCC Board of Governors fee waiver program. Current law requires that eligibility for a Cal Grant and the determination of financial need be accomplished using the Free Application for Federal Student Aid (FAFSA), and that this application be used for all programs funded by the state or a public institution of post-secondary education, as well as all federal programs administered by an educational institution. Current law makes an exception to this requirement for the Board of Governors fee waiver program which is authorized to use a simplified application designed for that sole purpose (Education Code § 69432.9 and § 69433).

FISCAL EFFECT: Unknown

### COMMENTS:

In citing the need for the bill, the author's office provides the following:

*According to a 2012 report by the U.S. Public Interest Research Group, Campus Debit Card Trap, banks and financial firms are forming partnerships with colleges and universities to produce campus ID cards and to offer student aid disbursements on debit or prepaid cards. The federal government requires that schools disburse financial aid refunds to students free of charge; however, these debit cards can come with fees for other services that can take away from students' aid. As a result students end up bearing some costs directly, including per-swipe fees, inactivity fees, overdraft fees, ATM fees and more.*

*The report contends that debit cards for disbursing funds may be good for colleges, but argue that cash-strapped students absorb the costs. The U.S. Public Interest Research Group study finds that some debit cards come with fees as high as 50 cents per swipe in transaction fees, \$38.00 per overdraft and \$10.00 for inactivity after six months without use. The PIRG study also finds that students do not fully realize what they are signing up for when they elect to receive their financial aid award via debit card.*

*A February 2014 report by the United States Government Accountability Office (GAO) identified the nonbank financial firm Higher One as the dominant provider with 57 percent of the market share. Higher One has contracts with a number of the California Community Colleges and Districts, as well as a partnership with California State University Fresno to distribute financial aid, including CalGrants.*

*In August 2012, the Federal Deposit Insurance Corporation (FDIC) ordered Higher One to pay restitution of nearly \$11 million to approximately 60,000 students for unfair and deceptive practices, and was obligated to pay \$110,000 in civil penalties. Most recently in November 2013, Higher One entered an agreement to settle a class action lawsuit for \$15 million. The lawsuit was initiated by students who claimed they were being charged excessive fees and were misled by marketing that inferred Higher One's product was the schools' preferred method of receiving financial aid.*

*The GAO also reports that many concerns have been raised over revenue sharing agreements that may exist between colleges and contracted third-parties. Federal officials and consumer advocates question whether the payments or benefits that a college receives may encourage schools to choose a contract that provides the school the most revenue, as opposed to a contract that best serves the needs of the students.*

AB 1927 arises out of concern that college students in California that receive some form of financial aid via debit card may not be aware of the actual costs of using this method of receiving aid, and that the relationship between educational institutions and financial institutions has created pressure to over promise and under deliver the benefits of a debit card use for financial aid delivery. The GAO released a report in February 2014, *College Debit Cards, Actions Needed to Address ATM Access, Student Choice, and Transparency* that raised several concerns that are the subject of this legislation. The GAO report found that the use of debit cards can be beneficial for students and schools. The use of cards for aid disbursement can lower the costs of issuing paper checks, decrease chances of fraud, expand functionality and defray costs of student ID cards. These cards also provide revenue generation opportunities for campuses as some campuses and card providers have payment arrangements based on card activity that can bring in extra money to the campus. Additionally, financial aid offices can outsource their disbursement activities and the accompanying overhead costs to the card providers. These cards can benefit students by providing a way to enter the mainstream as some college students are unbanked. When such cards are linked to the student's ID card it can provide multipurpose convenience as a single card can perform banking functions and facilitate access to campus buildings and library services. Funds can be available the same day that they are released to the provider, versus 2-3 business days of direct deposit, or 5-7 days for paper check.

The GAO report examined the common complaints arising from the use of debit cards for financial aid disbursement. The following are some of the GAO findings:

**Fees:** Generally the fees charged for the use of college debit cards were similar to those fees charged for basic checking accounts offered by national banks. Fees were also lower for college debit cards than for alternative financial services like check cashing stores. The GAO found that fees for transactions involving personal identification numbers (PIN) exceeded those of traditional bank accounts as Higher One and Citibank, representing 60% of the market charge \$0.50 for transactions that use PIN rather than signature. No other basic or student checking account reviewed by GAO charged this fee. The fee can be avoided by authorizing a purchase with signature, but the signature option involves choosing the "credit" option on the point of sale device which be confusing for students as the card is a debit card, not a credit card. The use of student debit cards can also lead to the imposition of ATM charges if the student uses an out of network ATM. Typically, these fees range from \$2.00-\$3.00 per transaction plus the operator of the out of network ATM may also impose a surcharge of around \$2.00. However, these out of network ATM fees are very common across all types of traditional banking accounts.

**ATM access:** Out of network ATM charges may be common among all types of bank accounts, but the access to ATMs for college debit cards may create situations where students face surcharges that could otherwise be avoided. ATM coverage varies from school to school. Also, at some schools, students may face lengthy lines to access free ATMs, or that ATMs are in locations that are not available outside of normal business hours. Federal Department of Education (Education) regulations require that students have "convenient access" to ATMs or a branch office where students will not incur any costs making cash withdrawals from the bank in which the account was opened. The definition of "convenient" is that the branch office or ATM must be located on the institution's campus, in institutionally owned or operated facilities, or a location immediately adjacent to and accessible from the campus.

**Neutrality:** Concerns have arisen that school and industry practices may influence student's choice of the debit card option even when it may not be the best choice. Schools can appear to implicitly or explicitly endorse college cards via their relationship with the card provider and co-branding of the card. Many students believe that the co-branding is an endorsement and indication that the school has negotiated the best terms. Four of eight card providers interviewed by the GAO said that at least some of their agreements with schools include exclusivity clauses that bar other financial institutions from locating ATMs or an office on campus. Signing up for a college debit card is the option of the student, yet in some cases schools do not provide payment options in a clear or neutral fashion which appear to encourage the students to pick the college card over other options.

The GAO is not the only entity to report on this subject. On March 10, 2014 the United States Department of Education, Office of Inspector General (DOEOIG) released a report, "Third-Party Servicer Use of Debit Cards to Deliver Title IV Funds." DOE OIG performed work at schools that outsourced credit balance delivery gave servicers significant control over the Title IV funds delivery process and relied on them to meet Title IV regulations. However, the schools did not appear to routinely monitor all servicer activities related to this contracted function, including compliance with all Title IV regulations and student complaints.

- 1) Schools did not prevent their servicers from using marketing and other strategies to persuade students to select their debit card over other available options.
- 2) The schools' servicers appeared to deliver Title IV funds to students without charging fees. However, students who chose a servicer's debit card option could incur fees after the servicer deposited the funds into the student accounts. In some cases, those fees appeared to be unique or higher than those of the alternative financial service providers.
- 3) Schools had financial incentives in their contracts with servicers that created the potential for conflicts of interest that could influence school officials' decisions and actions at the expense of student interests.
- 4) Schools that contracted with Higher One had fee-free ATMs on campus, but one school that contracted with Sallie Mae did not.
- 5) Schools provided, or servicers collected, student information that was not needed to deliver credit balances. In addition, the schools did not monitor servicer activities for compliance with Federal requirements for handling personally identifiable information.

Pending federal rules.

In response to a series of public hearings and outreach efforts, Education began a negotiated rule making process to expand the rules governing disbursement of financial aid via debit cards. The proposed rules are as follows:

- 1) The school must disclose conspicuously on its website, or otherwise make public, the contract arrangement in its entirety.
- 2) Prior to the student or parent activating a debit card for the disbursement of funds the school must do the following:
  - a) Inform the student or parent of the terms and conditions of the account, and obtain in writing affirmative consent from the student or parent to open the account;
  - b) Review any information that is provided to the student or parent about the account, and the debit card associated with the account, to ensure that the information is presented to the student in an objective and neutral manner;
  - c) Acquire consent from the student or parent prior to sending a debit card, prepaid card, or access device associated with the account;
  - d) The school may not offer a debit card associated with the account that bears the institution's logo or mascot, or that otherwise implies an affiliation with the institution;
  - e) The school may not make any claims against the funds in the account without the written permission of the student or parent, except for correcting an error in transferring the funds in accordance with banking protocols;
  - f) The school shall ensure that the student does not incur any cost in—
    - i) Opening the financial account or initially receiving the debit card, prepaid card, or access device associated with the account;
    - ii) Maintaining the account; or
    - iii) Using the debit card to conduct any transaction at any ATM located in any State as defined in 600.2;
  - g) Must ensure that the debit card associated with the account can be used nationally;
  - h) May not market or portray the financial account, debit card as a credit card or credit instrument, or subsequently convert the account, card, or device to a credit card or credit instrument;
  - i) May not charge the student or parent any overdraft fees if the financial account is overdrawn;

- j) Must ensure that:
  - i) The provider of the card or device provides the student or parent with pass-through deposit or share insurance; and,
  - ii) The card or device does not have an attached line of credit or loan feature under which repayment from the account is triggered upon the delivery of a Federal payment, including a deposit or transfer of title IV, HEA program funds into the account; and
- k) The account provides the student or parent with all the consumer protections that apply to a payroll card account under the Electronic Fund Transfers Act; and,
- l) Ensure that the financial account is in the student's or parent's name, or for a financial account that is a pooled custodial account, the subaccount (or card or device) is in the student's or parent's name. The custodial bank account must be established in the name of the institution or the institution's third party servicer, and must be set up to ensure that any title IV, HEA program funds that become the pooled funds of the custodial account are credited immediately to the student's or parent's subaccount (or card or device).

These proposed rules are subject to ongoing negotiations as Education has recently announced the addition of a fourth round of meetings to occur in mid-May 2014. The background documents and comments submitted concerning these proposed rules and the rule making process are available at

<http://www2.ed.gov/policy/highered/reg/hearulemaking/2012/programintegrity.html>.

#### Discussion.

The April 10, 2014 version of this bill was heard in Assembly Banking & Finance Committee on April 21<sup>st</sup>. The bill was not taken up for a vote at that time as the committee and author wanted to provide more time for various parties to address some of the issues brought up during the hearing.

#### Fees.

The proposed mock-up under consideration would require that the contracts between educational institutions and card issuers avoid unreasonable fees, including any fees charged by the financial institution for point of sale transactions. It is next to impossible to avoid all fees relating to financial account transactions and maintenance. Even debit cards issued for unemployed insurance benefits, or public assistance have the potential for user fees. As the GAO report compared financial aid debit cards with typical financial institution checking accounts they found that even with the most basic starter checking account not all fees can be avoided. This unfortunately has become part of life for consumers. However, the mock-up of AB 1927 attempts to address the one specific fee that is rarely, if ever, included with traditional checking accounts. That is the imposition of a PIN fee by the financial institution. It is possible to be charged a fee by a retailer when using a debit card, but typically the issuer of the card does not charge such fees. The GAO report found that some financial aid debit card issuers have charged this fee to students and that this type of fee is not in the conventional checking account marketplace. This bill would prohibit unreasonable fees, including a point of sale fee charged by

the card issuer. This would place the potential fees that could be charged to a student debit card more in align with the fees that they would face if they established a checking account with a bank or credit union.

Pending federal regulations.

As referenced earlier, the issues around student debit cards have raised a number of questions and concerns. The concerns have led to a rulemaking process that is currently underway with Education and various stakeholders in order to finalize proposed rules (Outlined on page 6 of this analysis) that in many ways significantly overlap with the proposed policies of AB 1927. Typically, when these cases arise in which a legislative remedy is proposed to an issue that is subject to pending federal regulatory action the committee is advised to act with caution. Often, this caution is reflected via a recommendation that the proposed legislative solution should be held in committee until such time as the federal regulatory landscape becomes clear. Nevertheless, delayed action is not always recommended, as each case must be evaluated subject to the specific facts relating to the policy issues.

This committee, has on some occasions, allowed measures to move forward even with pending federal action. Several reasons may justify further action. First, that the issue is of such importance to the state of California that the Legislature has a duty to react to federal action to potentially enhance and exceed federal regulations. Second, that the proposed federal rules, subsequent to the rule making process, may not provide the protections that the Legislature deems necessary for the issue at hand. Finally, that potential state action does not create conflict, or the potential for different sets of federal and state rules that could actually weaken the regulation of a specific issue, rather than strengthen it. In weighing these issues staff identifies that the issues contained in AB 1927 meet the tests as outlined previously. Is this issue of such importance to California that specific state action may be needed? Yes, According to the National Center for Education Statistics, California is number one in the nation with 2.6 million students attending post-secondary institutions meaning that the issue of student debit cards potentially harms California more than other states. Will the proposed rules provide the protection necessary? While the proposed draft rules are strong, it is difficult to determine how they will look after completion of the federal rulemaking process. Finally, would AB 1927 create a conflict? The proposed Education rules and AB 1927 may overlap but staff does not believe that the federal rules and AB 1927 create conflict in California.

In spite of the reasons outlining why pending federal regulation should not delay this proposal, the committee may want to consider that once the regulations are finalized that the this bill should be called back to committee for further action in order to resolve any conflict that could occur.

Preemption

Opposition to AB 1927 has argued that the ban on fees in the bill is prohibited under the National Bank Act (NBA) and therefore should AB 1927 become law it would be preempted in relation to its enforcement pertaining to national banks. The issue as to whether a state law is preempted is best left to the courts to decide. Conversely, at times some issues are clearer as to whether they may be potentially preempted. In the present case, the preemption argument is very tenuous. The NBA and subsequent court decisions that preempt state law typical preempt direct state action or enforcement against national banks. AB 1927 requires educational institutions to meet



the standards in the bill when negotiating contracts for student debit cards. National banks are not required to do anything specified in AB 1927. Frankly, in the post Dodd-Frank era federal preemption doctrine is not a broad battle axe swinging its way through state laws allowing national banks to abandon compliance with state laws. National banks, may in some way, be indirectly affected by the outcome of AB 1927, but that does not equate to federal preemption. AB 1162 (Frazier) of 2013 is telling in this regard. The provisions of AB 1162 were substantially similar to the provisions of AB 1927. This is important because the author requested an opinion from Legislative Counsel on the preemption question as it related to AB 1162. Staff believes these two bills are so similar that the Legislative Counsel Opinion on AB 1162 is analogous to AB 1927. The following are some highlights of that opinion:

*In our view, merely encouraging a educational institution to consider certain issues when adopting contract negotiation policies, even if those issues relate to banking account fees, does not amount to regulation of the manner, content, or terms and conditions of a financial transaction or related account. AB 1162 would not prohibit, or set any condition on, the exercise of a power granted to a national bank. Further, if a national bank agreed to a contract with a postsecondary educational institution that included contract provisions relating to those specified issues then the contract would not be preempted because contractual obligations voluntarily agreed to by a national bank that are more restrictive than federal law are not preempted—See Smith v. Wells Fargo Bank, N.A. (2005) 135 Cal.App.4<sup>th</sup> 1463, 1483; Gibson v. World Savings & Loan Assn. (2002) 103 Cal.App.4<sup>th</sup> 1291, 1299-1300.*

*Even if a court were to interpret the provisions of AB 1162 to require postsecondary educational institutions to include a specific contractual provision relating to fees in certain contacts with a national bank, we think that the marketplace participant doctrine exception to federal preemption...would apply in this context.*

*We believe the provisions of AB 1162, if enacted, would reflect only the state's desire to ensure that certain postsecondary educational institutions of the state deliver goods and services efficiently, and are not intended to impose a particular policy on a national bank. Moreover, since AB 1162 is narrowly drawn to apply only to specific types of contracts and to provisions that best serve the needs of students, we think that the marketplace participation doctrine would apply.*

*When supplying financial aid to a student, the state has an interest, just as any private party that provides financial aid would have, to ensure that the financial aid is delivered to the student in a form that is efficient and cost effective, and in a readily accessible manner." Indeed, federal regulations require an institution that provides federal financial aid to a student by creating an account for that student at a bank, to ensure that "the student or parent does not incur any cost in opening the account or initially receiving any type of debit card, stored-value card, or other type of automated teller machine (ATM) card, or similar transaction device that is used to access the funds in that account." (34 C.F.R. § 668.164.) Thus, the state requiring, in a capacity, specified protections for students would appear to be consistent with the goals federal regulatory law that also relate to the protection of students. In short we think that AB 1162 would not be enforcing a particular policy on a national bank, but, instead, would only be rationally exercising the authority of the state to narrowly use its proprietary powers to ensure an effective delivery of goods and services for contracts in which it is directly involved. –See*

*South Coast Air Quality Management*, supra, 498 F.3d at p. 1041; *Mayor of City of New York*, supra, 4 Misc.3d at pp. 155-156.

Furthermore, opponents have pointed to an overly broad legal opinion that claims that AB 1162 would be preempted and by extension so would AB 1927. Much of the justification for this belief relies on previous court cases such as:

Municipal ordinances that prohibited national banks from charging ATM fees to nondepositors. *Bank of America, N.A. v. City and County of San Francisco*, 309 F.3d 551, 564 (9th Cir. 2002), cert denied, 538 U.S. 1069 (2003).

\$800 underwriting fee imposed by a national bank for the refinancing of mortgage loans. *Martinez v. Wells Fargo Home Mortg., Inc.*, 598 F.3d 549, 556 (9th Cir. 2010).

State law claims alleging that bank's practice of ordering customer checks and debit card instructions using a protocol of "high-to-low" posting is an "unfair" business practice. *Gutierrez v. Wells Fargo Bank, N.A.*, 704 F.3d 712 (9th Cir. 2012).

State law claims alleging that federal savings and loan association's policy not to refund lock-in fees after applicants cancelled transaction. *Silvas v. E\*Trade Mortg. Corp.* 514 F3d 1001, 1006 (9th Cir. 2008).

Claim by judgment creditors seeking to compel national bank to turn over garnished funds without deducting a garnishment fee. *Monroe Retail, Inc. v. RBS Citizens, N.A.*, 589 F.3d 274, 284 (6th Cir. 2010.) State law claims by mortgagor that attacked lender's allegedly hidden fees. *Newsom v. Countrywide Home Loans, Inc.*, 714 F.Supp.2d 1000, 1010–1011 (N.D. Cal. 2010).

State law claims that mortgage lender failed to adequately disclose that the "teaser" rate would only apply for one month and that the scheduled monthly payments would be insufficient to repay interest and principal. *Conder v. Home Sav. of America*, 680 F.Supp.2d 1168, 1176 (C.D. Cal. 2010).

While these cases establish the core case law of federal preemption of state laws regarding national banks, not one of these cases is analogous to AB 1927. Each case involved a state law that directly regulated the actions of a national bank whereas AB 1927 specifies the minimum contract standards between an educational institution and a student debit card issuer. The responsibilities and burden of compliance is placed on the educational institutions. Furthermore, the Office of Comptroller of Currency (OCC) regulations contained in *12 C.F.R §704007(b)(2)* specify:

*State laws on the following subjects are not inconsistent with the deposit-taking powers of national banks and apply to national banks to the extent consistent with the decision of the Supreme Court in Barnett Bank of Marion County, N.A. v. Nelson, Florida Insurance Commissioner, et al. 517 U.S. 25 (1996):*

*(1) Contracts;*

*(2) Torts;*

*(3) Criminal law;*

AB 1927 is clearly a case concerning the state's authority to regulate contracts.

Amendments.

This bill is being heard in mock-up form. This analysis reflects the changes in the mock-up.

REGISTERED SUPPORT / OPPOSITION:

Support

California Communities United Institute  
CALPIRG  
Faculty Association of California Community Colleges (FACCC)  
The Student Senate for California Community Colleges  
University of California Student Association (UCSA)  
9 individuals

Opposition

California Bankers Association (CBA)  
Higher One

Analysis Prepared by: Mark Farouk / B. & F. / (916) 319-3081