

Date of Hearing: July 6, 2015

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Matthew Dababneh, Chair

SB 235 (Block) – As Amended May 5, 2015

**SENATE VOTE:** 39-0

**SUBJECT:** Small dollar loans: finder duties and compensation.

**SUMMARY:** Expands activities allowed for finders under the Pilot Program for Increased Access to Responsible Small Dollars Loans (Pilot). Specifically, **this bill:**

- 1) Authorizes finders under the Pilot to provide the following services, in addition to those currently allowed under existing law, on behalf of pilot lenders with which they have a written agreement, if the finders are licensed as financial service providers under one of thirteen different state or federal laws specified in the bill:
  - a) Disburse loan proceeds to a borrower, if this method of disbursement is acceptable to the borrower, and receiving loan payments from a borrower, if this method of payment is acceptable to the borrower. Any loan disbursement made by a finder to a borrower is deemed made by the pilot lender on the date that funds are disbursed or otherwise made available by the finder to the borrower. Any loan payment made by a borrower to a finder is deemed received by the pilot lender as of the date the payment is received by the finder; and,
  - b) Provide any notice or disclosure required to be provided by the lender to the borrower.
- 2) Specifies that a finder that disburses loan proceeds or accepts loan payments must provide a receipt to the borrower containing specified information including a statement of the following, “If you have any questions about your loan, now or in the future, you should direct those questions to [name of Pilot program lender] by [insert at least two different ways in which a borrower may contact the pilot lender].”
- 3) Requires the finder to maintain records of all disbursements made and loan payments received for a period of at least two years or until one month following the completion of a regular examination by the commissioner of Business Oversight (commissioner), whichever is later.
- 4) Replaces the reference to finder’s “fees” in existing law with a reference to finder’s “compensation;” increases the maximum amount of compensation a pilot lender may pay its finder to the lesser of \$70 per loan or the sum of the origination fee and interest charges paid by the borrower to the lender over the life of the loan; and clarifies that this compensation may be paid at the time of consummation, over installments, or in a manner otherwise agreed upon by a pilot lender and a finder.
- 5) Provides that a borrower who submits a loan payment to a finder under this subdivision shall not be liable for any failure or delay by the finder in transmitting the payment to the licensee.

- 6) Requires pilot lenders that use finders to submit specific information to the commissioner regarding the performance of loans consummated with the use of finders, and authorizes the commissioner to use this information when deciding whether a finder should be disqualified from performing services for one or more pilot lenders.

**EXISTING LAW:**

- 1) Until January 1, 2018, authorizes the Pilot within the California Finance Lenders Law (CFL), administered by the Department of Business Oversight (DBO); Financial Code Sections 22365 et seq.).
- 2) Authorizes CFL licensees that are approved by the commissioner to participate in the Pilot to use the services of one or more finders. Defines a finder for purposes of the Pilot as an entity that, at the finder's physical location for business, brings a pilot lender and a prospective borrower together for the purpose of negotiating a loan contract (Financial Code Section 22371).
- 3) Authorizes finders to perform up to eight different types of activities for a pilot lender at the finder's physical location for business. These activities generally involve distributing information about Pilot program loans to prospective borrowers and acting as a communications link between prospective borrowers and pilot lenders (Financial Code Section 22372).
- 4) Prohibits finders from engaging in activities that require a broker's license. Prohibited activities generally involve providing advice to borrowers and negotiating loan terms (Financial Code Section 22372).
- 5) Authorizes pilot lenders to compensate finders pursuant to a written agreement, subject to specified limitations. These limitations generally prohibit payment for unconsummated loans, prohibit lenders from passing on finder's fees to borrowers, and cap the maximum size of finder's fees at specified amounts (Financial Code Section 22374).
- 6) Requires each pilot lender that utilizes the services of one or more finders to inform the commissioner regarding the identities of and contact information for their finders; pay an annual finder registration fee to the commissioner to cover the commissioner's costs to regulate their finders; and submit an annual report to the commissioner, containing whatever information the commissioner requests related to the finder's finding activities (Financial Code Section 22375).
- 7) Authorizes the commissioner to examine the operations of each finder. Gives the commissioner authority to disqualify a finder from performing services under the Pilot, bar a finder from performing services at one or more specific locations, terminate a written agreement between a finder and a pilot lender, and prohibit the use of a finder by all pilot lenders accepted to participate in the Pilot, if the commissioner determines that the finder has violated the Pilot rules or regulations (Financial Code Section 22377).

**FISCAL EFFECT:** Unknown

**COMMENTS:**

The Legislature and Governor in 2010 enacted the Affordable Credit Building Opportunities Pilot Program (ACBO), placing it under the CPLL. The goal was to increase consumers' access to capital by encouraging development of a more robust small dollar loan market in California. The ACBO – established by SB 1146 (Florez) – took effect January 1, 2011. Its provisions applied to consumer loans of \$250 to \$2,499. To incentivize lenders' participation, the ACBO allowed them to charge borrowers marginally higher interest rates, and larger origination and delinquency fees than those permitted for CPLL consumer loans of that size made outside the program.

A low lender participation rate led to ACBO's demise. It was replaced by the Pilot, created in 2013 under SB 318 (Hill). The Pilot – Financial Code section 22365 et seq. – took effect January 1, 2014. It will remain in effect until January 1, 2018, unless extended by the Legislature and Governor.

According to the author:

Relatively few installment loans are made in California with principal amounts under \$2,500. This represents a challenge to the significant population of people in California who are unable to access affordable credit through banks and credit unions. Californians who lack credit scores, or have very thin credit files or damaged credit, currently have very few affordable options when they need to borrow money. Credit cards are often unavailable to this population, or, if available, bear very high interest rates and fees. When their spending needs outpace their incomes, these Californians commonly turn to payday loans, auto title loans, or high-interest rate, unsecured installment loans. All three of these options come with high costs, and none rewards timely loan repayment with a credit score increase.

Recognizing California's shortage of affordable, credit-building loans, the California Legislature authorized a small-dollar loan Pilot program in 2010 (SB 1146, Florez, Chapter 640, Statutes of 2010). The Legislature modified that Pilot program in 2013, based on Pilot participants' first two years of experience, with the aim of attracting more lenders to the program and increasing the viability of lenders participating in the Pilot (SB 318, Hill, Chapter 467, Statutes of 2013). SB 235 proposes to modify one element of the 2010 Pilot that has not yet been updated to reflect knowledge gained through Pilot participants' experience: the finder provisions.

As envisioned in the 2010 legislation, finders are third parties who can work on behalf of Pilot program lenders to identify prospective borrowers and connect them with the lenders, helping to lower pilot program lenders' costs of customer acquisition. Until very recently, however, no pilot program lender had utilized the finder authority granted in the 2010 legislation, because the finder provisions have proven too rigid for the realities of the small dollar loan marketplace. SB 235 is premised on the belief that the finder provisions require revision, if the Pilot program is to achieve its full potential.

AB 235 is sponsored by Insikt Corporation, parent company of Lendify, a new entrant to the Pilot. Insikt has devised a way to utilize finders as an integral part of its business model in order to reduce overhead costs and expand access to capital. In attempting to operate this model Insikt

has faced some challenges with the existing statute authorizing the Pilot. Existing law is silent on whether finders may disburse loan proceeds or collect loan payments. The model Insikt uses seeks to give consumers a choice as to the location they want to make payments on their loan and even where they want to receive loan disbursement. In this capacity the use of finders allows the licensee to have a network of lending and repayment centers at varied locations with the costs associated with a branch office model.

The original 2010 legislation authorized only one method of finder compensation: a per-loan fee paid by a Pilot program licensee to a finder at the time of loan consummation at \$45 per loan for the first 40 loans originated each month at a finder's location and \$40 per loan for any subsequent loans originated during that month at a finder's location. At the time of its creation the finder's provision under the Pilot was envisioned as a way to utilize retailers or small businesses as potential loan pipelines to assist with connecting borrower with lender. However, the restrictions put in place that effectively limit compensation negotiations between lender and finder have left this an unused provision of the Pilot. Insikt would like to pay its finders as loans are repaid, rather than upfront and to compensate finders based on negotiated amounts rather than on a per loan basis. Existing law prohibits finder's compensation from being passed on to the borrower so the borrower is not affected by whatever the fee may be. Recent amendments have removed the ability to negotiate finder compensation and instead have revised the existing fee per loan cap up from \$45 to \$70.

Finally, existing law requires finders to report specific information to the commissioner of DBO. SB 235 would expand that information to include certain loan performance metrics relating to loans facilitated by finders.

#### Filling the Void.

Consumers in need of small dollar credit or to build their credit score and history have had little in the way of mainstream options available. Few banks or credit unions offer small dollar loans instead relying on overdraft protection programs. Some banks offered pay check advance products but due to regulatory and consumer group pressure they no longer offer those options. Some research reveals that users of non-traditional lending products also have credit cards, though it is unclear what the annual percentage rate and balance on the available card might be. The clear fact is that for the no credit/low credit consumer credit options are expensive and may not serve the actual need of the borrower. Prior to the Pilot lending within the space of \$300-\$2,500 was not meaningful. The CFLL contained interest rate restrictions up to \$2,500 with virtually no restrictions above this amount. This effectively created an incentive for loans outside of the interest rate caps above \$2,500 and on the lower end up to \$300 for payday loans. The Pilot was created in 2010 to open up the lending market between \$300 and \$2,500 by loosening some of the interest rate caps in the CFLL and instead required extensive underwriting in exchange for increased interest and fees. The Pilot has required tweaks as evidenced by SB 318 (Hill) of 2013 and this bill currently under consideration. To make these loans work innovation and creativity are key components needed to drive down overhead and loan acquisition costs. The goal of the original Pilot was to create a competitive market place what would provide affordable loans to consumers that could compete and eventually overtake more costly options. Currently, six Pilot lenders are operational with Oportun (formally Progresso Financial) the leading Pilot lender. In total, since its inception approximately 200,000 Pilot loans have been made, most of them by Oportun. In context, almost three million payday loans are made per year and approximately

300,000 loans under the CFLL are made with no interest rate cap. According to the Consumer Financial Protection Bureau, 20% of Americans have no credit score or history and this percentage don't include those consumers that can't get affordable loans due to damaged credit.

### Pilot Performance.

DBO recently released (June 2015) a report, *Report of Activity Under Small Dollar Loan Programs*, on the performance of the ACBO and the Pilot covering January 1, 2011 to December 31, 2014. The data presented in the report includes loans arranged without a finder as finder activity was very limited and not reported until 2014. The following are highlights from the report:

- Loan applications – Borrower applications increased by 58.5 percent over the period, from 207,092 in 2011 to 328,198 in 2014. The loan approval rate increased from 39 percent in 2011 to 50 percent in 2014.
- Aggregate principal – The annual total principal of loans made increased by 83.8 percent over the period, from \$97.9 million in 2011 to \$179.9 million in 2014.
- Dollar amounts – Loans made in the \$300-\$499 range fell by 42.3 percent over the period, from 1,518 in 2011 to 876 in 2014. Loans made in the highest range, from \$1,500 to \$2,499, increased by 106 percent, from 21,349 to 43,975.
- Interest rates – Of the 6,560 loans made in the \$300-\$499 range over the period, 73.9 percent carried an annual percentage rate (APR) of 40 percent to 49.99 percent. In the \$500-\$999 range, 43.4 percent carried APRs of 40 percent to 49.99 percent, while 25.2 percent had APRs of 35 percent to 39.99 percent. In the \$1,500-\$2,499 range, the APR distribution was more even. In that category, 42.8 percent of the loans had APRs of 35 percent to 39.99 percent, while 19.6 percent had APRs of 30 percent to 39.99 percent, 18.2 percent had APRs of 40 percent to 49.99 percent, and 15.6 percent had APRs of 25 percent to 29.99 percent.
- Delinquencies – Of the 164,300 loans made in 2014, 22.5 percent were delinquent for seven days to 29 days, 7.3 percent were delinquent for 30 days to 59 days, and 3.9 percent were delinquent for 60 days or more.
- Multiple loans – The number of borrowers who took out more than one loan jumped dramatically from 2011 to 2012. Since then, however, the upward trajectory has been less steep. The number went from 2,189 in 2011 to 10,804 in 2012. From 2012 through 2014, the number rose by 21.6 percent, to 13,136. Of the 13,136 multiple-loan borrowers in 2014, 12,999 took out two loans.
- Credit scores – The share of multiple-loan borrowers who obtained higher credit scores on subsequent loans averaged 61 percent annually over the four-year period. The average size of the increase for those borrowers jumped from 34 points in 2011 to 355 points in 2014.
- Loan term – In 2014, of the 164,300 loans made, 50.9 percent were for 360 days or more.

The ratios for other terms: 120 days to 179 days, essentially 0 percent (only two loans); 180 days to 269 days, 20.2 percent; and 270 days to 359 days, 28.8 percent.

- Borrower income – Of the 486,287 loans from 2011-2014, 18.4 percent were made in low-income neighborhoods. The ratios for other neighborhood income levels: moderate-income, 45.4 percent; middle-income, 21.1 percent; and upper-income, 4.4 percent. The annual low-income ratio increased from 16.6 percent in 2011 to 19.5 percent in 2014.
- Loan purpose – Of the 164,300 loans made in 2014, borrowers took out 45 percent (74,026) to build or repair credit. Ratios for other purposes: medical or other emergency, 18.4 percent; pay bills, 12.7 percent; consolidate debt, 5.7 percent; non-vehicle purchase, 5.3 percent; vehicle purchase, 2.7 percent; vehicle repair, 2.6 percent; other, 6.4 percent.

### Negotiations

This bill was originally scheduled to be heard on June 22, 2015 but was pulled from hearing to give the author, sponsor and proponents time to discuss several outstanding issues. The committee analysis previously commented that it was unclear as to what issues were left on the table for discussion and negotiation. In the last two weeks interested parties have conducted several negotiation sessions to discuss the remaining issues of disagreement. Based on the substance of those discussions, staff believes that the major issues are the following:

- 1) AB 235 gives finders new duties that they do not have under existing law. These duties include the ability to disburse loan proceeds and collect loan payments. Existing law prohibits the finder from answering the borrower's questions about specific loan terms. As an alternative, the bill envisions that the finder would assist the borrower with communicating with the lender to get those questions answered. The form and timing of that communication have been issues of dispute. The discussions have led to a resolution that, with some suggested staff changes, are reflected under "suggested amendments."
- 2) The second major issue concerns finder compensation. Currently, SB 235 caps the finder compensation at \$70 per loan. Opponents and the sponsor have discussed various approaches to compensation including a cap with an additional authorization for a \$1-\$2 fee for each payment accepted. Other alternatives include a lower cap that would be in the aggregate versus a loan level cap. Opponents are concerned that an increase in finder compensation could potentially lead to bad actors entering the pilot as finders. Staff notes 1) Finder compensation may not be charged to the borrower; 2) The bill requires that finders must be licensed under one of several existing licensing laws therefor affording additional review by their regulator; 3) No other lending law includes the restrictions and oversight included in the Pilot both for lenders and finders; and 4) There are far easier places to potentially rip off consumers than under the Pilot.

The sponsor has offered language that would lower the dollar amount of the cap to \$60 but have the cap apply on an aggregated basis. The finder compensation structure remains the most contentious issue and at this time is best left to further discussions to find a reasonable

compromise that balances consumer protection with realistic expectations concerning the cost structure of loans under the pilot.

Suggested amendments:

Committee staff suggest the following amendments:

- 1) As mentioned in the comments under the "negotiations" section a finder is required, when an applicant has a question that the finder is prohibited from answering about the loan to assist the applicant in making direct contact with the lender. At a minimum this includes assisting the applicant in communicating with the lender in real time via telephone, video chat or instant messaging. It is unclear how the finder is supposed to "assist" the applicant in making contact with the licensee. The analysis for the June 22<sup>nd</sup> hearing highlighted the difficulties with this approach. Based on discussions between interested parties, staff recommends the following amendments to address this issue:

Add new section amending Section 22370 of the Financial Code concerning the requirement of licensees that states:

**(f) The licensee shall develop and implement policies and procedures designed to respond to questions raised by applicants and borrowers regarding their loans, including those involving finders, and to address customer complaints as soon as reasonably practicable.**

Provide a way for finders to assist communication between the borrower and the lender.

Page 6, Lines 31-37 would read as follows:

*(b) If the loan applicant has questions about the loan that the finder is not permitted to answer, the finder shall make a good faith effort to assist the applicant in making direct contact with the lender before the loan is consummated. This good faith effort shall, at a minimum, consist of ~~assisting the applicant in communicating with the lender in real time via telephone, video chat, or instant messaging.~~ **assisting the applicant in communicating with the licensee as soon as reasonably practicable, which shall at a minimum include a "two-way communication."** For purposes of this section "two way communication" includes **telephone, email or another form of communication that allows the applicant to communicate with the licensee.***

**(c) Using the policies developed pursuant to subdivision (f) of Section 22370, the licensee shall ensure that a loan is not consummated until the licensee has completed a "two-way communication" with the applicant. Sending a voicemail or electronic message to the applicant, without a prior or subsequent response from the applicant, shall not constitute a "two-way communication."**

- 2) Some additional changes are necessary for technical and consistency reasons. Page 8, lines 22-27 includes changes to the existing law requirement that finders submit a report to the commissioner. The new requirements include information about delinquency and default rates, and number of late fees assessed to borrowers. This is substantially similar to information that must be reported by Pilot licensees under existing law. Staff recommends amendments that require the finder report to include the loan level information required of licensees.

(c) Submit an annual report to the commissioner ~~including any~~

*including, for each finder, the information listed in paragraph (12) and subparagraph (A) of paragraph (13) of Section 22380, delinquency and default rates, number and dollar amount of late fees assessed to borrowers on consummated loans, and any other information pertaining to each finder and the licensee's relationship and business arrangements with each finder as the commissioner may by regulation require.*

- 3) In relation to #2, under existing law, Financial code 22380(b) the report compiled in relation to information that licensees must provide is exempt from public disclosure. Again, this is standard treatment of sensitive information that is often provided to regulators. Therefore staff recommends the following:

Page 8, after line 27 insert "*The information disclosed to the commissioner for the report described in this subsection is exempted from any requirement of public disclosure by paragraph (2) of subdivision (d) of Section 6254 of the Government Code.*

- 4) Staff recommends a technical amendment to remove an outdated reference to the Division of Corporations and update the telephone number and website address:

22373.(a) At the time the finder receives or processes an application for a program loan, the finder shall provide the following statement to the applicant, on behalf of the licensee, in no smaller than 10-point type, and shall ask the applicant to acknowledge receipt of the statement in writing:

“Your loan application has been referred to us by [Name of Finder]. We may pay a fee to [Name of Finder] for the successful referral of your loan application. IF YOU ARE APPROVED FOR THE LOAN, [NAME OF LICENSEE] WILL BECOME YOUR LENDER, AND YOU WILL BE BUILDING A RELATIONSHIP WITH [NAME OF LICENSEE]. If you have any questions about your loan, now or in the future, you should direct those questions to [name of licensee] by [insert at least two different ways in which a borrower may contact the licensee]. If you wish to report a complaint about [Name of Finder] or [Name of Licensee] regarding this loan transaction, you may contact the Department of Business Oversight, ~~Division of Corporations at 1-866-ASK-CORP (1-866-275-2677)~~, or file your complaint online at [www.corp.dbo.ca.gov](http://www.corp.dbo.ca.gov).”

- 5) A provision that prohibits a finder from discussing certain items with a borrower may conflict with another section that expressly allows a finder to discuss certain information. Therefore staff recommends the following:

Page 5, strike lines 23-25.

~~(3) Interpreting or explaining the relevance, significance, or effect of any of the marketing materials or loan documents the finder provides to a borrower or prospective borrower.~~



6) The following are technical corrections and updates requested by the sponsor to certain receipt and disclosures required to be offered by the finder.

Page 4, line 11 strike "number" and insert "identification"

(iii) The corresponding loan account *identification number*.

Page 4, lines 32-37 amend as follows:

(i) *The name of the finder.*

~~(i) *The date of payment.*~~

~~(H)~~

(ii) The total payment amount *received made*.

~~(H)~~

(iii) *The date of payment.*

~~(iv) The corresponding loan account *identification number* upon which the payment is being applied.~~

~~(v) *The loan balance prior to and following application of the payment.*~~

~~(vi) *The amount of the payment that was applied to principal, interest, and fees.*~~

~~(vii) *The type of payment (e.g., cash, ACH, check, money order, debit card, other).*~~

#### Previous Legislation.

- 1) SB 1146 (Florez), Chapter 640, Statutes of 2010: Authorized California's original small-dollar loan Pilot program within the CFLL, named the Pilot Program for Affordable Credit-Building Opportunities. Allowed lenders approved to participate in the Pilot program to charge higher interest rates and fees on loans of up to \$2,500 than those authorized under CFLL. Required Pilot program lenders to rigorously underwrite their loans, offer credit education at no cost to their borrowers, and report borrower payment history to at least one major credit bureau. Required detailed reporting of loan outcomes to DBO. Scheduled to sunset on January 1, 2015, but was replaced by the Pilot Program for Increased Access to Responsible Small Dollar Loans, as described immediately below, on January 1, 2014.
- 2) SB 318 (Hill), Chapter 467, Statutes of 2013: Replaced the Pilot Program for Affordable, Credit-Building Opportunities with the Pilot Program for Increased Access to Responsible Small Dollar Loans. Retained several aspects of the original Pilot, including the underwriting requirements, offers of free credit education, reports to at least one major credit bureau, and detailed reporting of program loan outcomes, but modified other aspects of the original Pilot program. These modifications increased the maximum interest rates and fees that Pilot lenders could charge, allow Pilot lenders to originate new loans and to refinance loans more frequently than under the original Pilot, and eliminated several administrative and licensing rules that were serving as bureaucratic barriers to the success of the original Pilot. Sunsets on January 1, 2018.

#### **REGISTERED SUPPORT / OPPOSITION:**

##### **Support**

Insikt (Sponsor)

Avanza Inc.

Check Agencies of California, Inc.

LendUp

Silicon Valley Leadership Group

uTax Software, LLC

**Opposition**

Center for Responsible Lending (CRL)  
Consumers Union (CU)

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