Date of Hearing: July 10, 2017

ASSEMBLY COMMITTEE ON BANKING AND FINANCE
Matthew Dababneh, Chair
SB 325 (Mendoza) – As Amended June 15, 2017

AS PROPOSED TO BE AMENDED

SENATE VOTE: 40-0

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

Note: *This analysis reflects late requested amendments by the author's office which the committee Chair has accepted. For clarity, the following summary contains what will be in the bill with the requested amendments followed by list of what is being taken out of the bill.*

SUMMARY: Makes changes to the Pilot Program for Increased Access to Responsible Small Dollar Loans (program) contained within the California Finance Lenders Law. Specifically, **this bill**:

1) Clarifies that allowable charges and fees imposed by lenders in connection with pilot program loans are not included in the "bona fide principal amount" calculation.

2) Allows a licensed lender to provide a borrower a "paid in full" notice, or optical reproduction thereof, a balance due of zero when a loan is consummated electronically.

3) Renames the term "finder" to "referral partner".

4) Requires a licensee to train each referral partner to ensure program compliance, as specified.

5) Deletes provisions requiring a second duplicate disclosure notification.

6) Contains provisions to recalculate the total compensation paid to referral partners without changing the total amount allowable.

7) Revises the content of the report annually submitted by the Commissioner of the Department of Business Oversight (DBO) to include information on borrowers that were denied participation in the program and additional borrower information as specified.

The proposed amendments remove the following provisions from the bill:

1) Removal of the program lending cap of $2,500, requiring compliance with pilot program provisions.

2) Creation of an additional mechanism for refinancing a loan when a borrower has repaid at least 60% of the loan and has been current for a minimum of eight consecutive months.

3) Allowing a referral partner to bring together borrowers and a licensee through online, mobile or in person marketing channels, as specified.

4) Prohibiting unsolicited door-to-door or telephonic solicitation of borrowers or prospective borrowers.

5) Altering the calculation for total compensation paid by a licensee to a referral partner by prescribing limits on compensation with reference to the length of a contractual loan.

EXISTING LAW: Until January 1, 2023, authorizes the pilot program within the California Finance Lenders Law (CFLL), administered by the DBO (Financial Code Sections 22365 et seq.). Generally speaking, the pilot program authorizes lenders who have been vetted by DBO to charge somewhat higher interest rates and fees on loans of principal amounts up to $2,500 than are allowed under the CFLL. The pilot program also authorizes pilot program lenders to use finders, as specified. Pilot program lenders must perform rigorous underwriting, provide extensive borrower disclosures, offer borrowers credit education prior to the disbursement of loan funds, and report borrower payment history to at least one major credit bureau – requirements that do not apply to CFLL licensees which are not pilot program lenders.

FISCAL EFFECT: Unknown

COMMENTS:

Background: 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.

In an attempt to increase the availability of affordable, credit-building installment loans made in California in amounts below $2,500, the California Legislature authorized a small-dollar loan pilot program in 2010 (SB 1146 (Florez), Chapter 640, Statutes of 2010). The Legislature modified the pilot program in 2013 and again in 2015, with the aim of attracting more lenders to join the pilot program and increasing the availability of pilot program loans across the state (SB 318 (Hill), Chapter 467, Statutes of 2013; and SB 235 (Block), Chapter 505, Statutes of 2015).

Existing law requires the Commissioner of DBO to issue periodic reports regarding the pilot program, to give the Legislature and interested parties information regarding pilot program usage and informing efforts to improve the pilot program's effectiveness. The first such report was issued in June 2015, and covered the period of January 1, 2011, through December 31, 2014.

Discussion:

"Bona fide principal amount" calculation: This bill seeks to clarify what is included in the calculation of what makes up a "bona fide principal amount". The author's office notes the disparity between loans that are currently made outside of the pilot program that do not contain allowable charges and fees to be included within the calculation of a "bona fide principal amount" and loans within the pilot program that do contain these allowable charges and fees was an unintentional consequence of earlier legislation. This change may result in minor increases in

the calculation of a "bona fide loan amount" within the pilot program. Aligning the method of calculating the "bona fide loan amount" inside and outside the pilot program will reduce confusion and eliminate an unnecessary inconsistency in the law.

Alternative notification of "paid in full": This provision does not remove the requirement for licensed lenders to inform borrowers of their "paid in full" status, but rather, seeks to update the means by which this notification may be made. The author's office notes:

> The alternate method authorized by the bill is intended to ensure that pilot program borrowers are given clear proof that they have fully repaid their loans, without subjecting pilot program lenders to the unnecessarily burdensome and expensive requirement to provide a copy of the borrower's original contract, marked "paid," whenever a pilot program loan is fully repaid. The requirement to provide hard copy of the original, signed contract is outdated in connection with loans that are consummated electronically, because contracts consummated online lack an actual borrower signature; typically, a borrower types his or her name on a signature line to verify consent.

Rename "finders" as "referral partners": The renaming of finders to "referral partners" is based solely on the belief of the author's office that the new name "better reflects the partnership role that these third parties play in pilot program lending." This renaming will likely have little or no impact on the effectiveness of the pilot program.

Training for referral partners: There is currently a concern that some referral partners may be operating in a manner that is not consistent with the intent of the consumer protections contained within the pilot program. To date there has not been sufficient data to substantiate these concerns. However, this bill includes increased training for referral partners to ensure that the consumer protections inherent within the pilot program are adhered to by all licensees and referral partners. It is the opinion of the Assembly Banking and Finance Committee staff that more training will lead to better outcomes within the program but that training alone will not prevent possible inappropriate behavior by referral partners.

Delete duplicate copy of disclosure: Disclosures on the details of a loan, the role of the lender, the referral partner and the DBO are essential in ensuring a borrower knows precisely the terms and obligations of a consumer loan. However, the author's office argues that a second set of disclosures that are sent to the borrower two weeks after the consummation of the loan creates confusion causing borrowers to wonder if there have been changes to the original disclosure document. It should be noted that this provision does not change the original disclosure requirement but simply removes the requirement for the second set of disclosures.

Recalculating total compensation to referral partners: This provision does not change the amount a referral partner may be paid, but rather, changes the means whereby the calculation of those payments is made. The author's office notes:

> Compliance with this provision is enormously burdensome on licensees and does not provide sufficient borrower protection to warrant its retention. Because the total amount of interest that will be paid by a borrower over the course of a loan is not known until that loan is fully repaid, this provision requires lenders to perform settle-ups each time a loan is repaid. As lending volumes increase, these settle-ups require more and more time to perform. Furthermore, because these calculations are

performed on a backward-looking basis, after a loan is fully repaid, they do not impact lender or referral partner behavior. Finally, this formula serves to penalize referral partners who help facilitate loans that are repaid early. Because early repayment saves borrowers money, it seems unfair to penalize a referral partner that helped facilitate a loan which cost a borrower less than originally anticipated.

Changes in information reported to DBO: As noted earlier in this analysis, there remain data gaps on the performance of the pilot program. The provisions contained within this section seek to increase the information provided to DBO. This information may be used to guide future changes to the program to increase consumer access and program efficiency. It should be noted, however, that increasing the amount of information reported to DBO may not yield immediate results as it takes a substantial amount of time, possibly years, for trends to emerge.

Prior Legislation:

AB 784 (Dababneh) of 2017: As proposed, increased the lending cap of the pilot program up to $5,000. The bill removed the sunset to the pilot program making the program permanent and raised the amount of an applicable bona fide loan amount from $2,500 to $5,000 in the California Finance Lender's Law (Financial Code Sections 22303, 22304, and 22305). *Status: Held in Assembly Appropriations Committee*.

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. Originally 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.

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 pilot 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, allowed 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. Scheduled to sunset on January 1, 2018.

SB 235 (Block), Chapter 505, Statutes of 2015: Expanded the activities in which pilot program finders could engage on behalf of pilot program lenders. Authorized finders to disburse loan proceeds to borrowers, receive loan payments from borrowers, and provide notices and disclosures to borrowers, as specified, and provided pilot program lenders with greater flexibility in the ways in which they may compensate their finders.

REGISTERED SUPPORT / OPPOSITION for the June 15, 2017, version of SB 325:

SUPPORT:

Insikt, Inc. (Sponsor)
Avanza Inc (d/b/a Listo!)
Dolex Dollar Express, Inc.
Kern Schools Federal Credit Union
Northgate Gonzalez
Northgate Gonzalez Financial (d/b/a Prospera)
Philippine National Bank Remittance Centers, Inc.

OPPOSE:

AARP California
Asian Law Alliance
Brightline Defense Project
California Association for Micro Enterprise Opportunity
California Capital Financial Development Corporation
California League of United Latin American Citizens
California Low-income Consumer Coalition
California Reinvestment Coalition
California Senior Leaders Alliance
California Teamsters Public Affairs Council
Center for Responsible Lending
Clergy And Laity United For Economic Justice
Coalition for Humane Immigrant Rights
Consumer Attorneys of California
Consumers for Auto Reliability & Safety
Consumers Union
Courage Campaign
East Bay Community Law Center
East LA Community Corporation
Greenlining Institute
Housing & Economic Right Advocates
Latin Business Association
National Council of La Raza
NEW Economics for Women
Nuestra Casa de East Palo Alto
Oportun
Peace and Freedom Party, California
Presente.org
Progressive Democrats of Santa Monica Mountains
Public Counsel
Public Good Law Center
Public Law Center
Riverside Legal Aid
San Fernando Valley Young Democrats
Silicon Valley Community Foundation

The Greater Los Angeles LULAC Council 3267
Western Center on Law and Poverty

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