May 17, 2023

Via Email to regulations@dfpi.ca.gov
Araceli Dyson, Regulations Coordinator
CC: Peggy Fairman, Senior Counsel at Peggy.Fairman@dfpi.ca.gov
California Department of Financial Protection and Innovation

RE: Rulemaking under the CCFPL, CFL, CDDTL, and CSLSA (PRO 01-21)

Dear Ms. Dyson:

We appreciate the opportunity to submit comments related to PRO 01-21 - Notice of Proposed Rulemaking Under the California Consumer Financial Protection Law and the California Financing Law, California Deferred Deposit Transaction Law, and California Student Loan Servicing Act.

We also appreciate the continued efforts by the California Department of Financial Protection and Innovation ("DFPI" or the "Department") to provide additional legal clarity for those groups providing funding to students utilizing income-contingent, income-indexed forms of financing, such as ISAs. We believe that income-contingent, income-indexed tools such as income share agreements (ISAs) are critical tools for expanding students' access to postsecondary education in a way that is affordable and designed around students' outcomes. These tools bring together several critical features for expanding access and affordability: (1) access to financing that is not dependent on a credit score or cosigner, (2) a payment obligation that is determined by the student's after-school income, and (3) a maximum duration after which the obligation ends even if the student's required payments do not cover the amount advanced.

While these tools can have these important benefits, they can be used in beneficial or problematic ways. We therefore fully support efforts by the Department to provide oversight of these tools. Because of how these tools differ from conventional loans, however, it is critical to craft regulations that address their unique features. Therefore, while we have some specific comments, questions, and concerns about aspects of this proposed rule, discussed further below, we appreciate the efforts of the Department to structure regulations that speak to tools with income-contingent, income-indexed features designed to protect students.

The following are suggestions related to the revised proposed regulations:

I. CLARIFY DEFINITIONS

A. Clarify the definition of "Income-Based Repayment"

The proposed rule defines "Income-Based Repayment" as "any arrangement in which the consumer's education financing payment obligation is based upon the consumer's income or employment status." We believe this definition is over-inclusive and risks including loans that offer deferral or forbearance

provisions but that do not offer all the elements necessary to fully protect students in an income-based repayment structure.

We therefore recommend amending the definition in the following way:

> *"Income-Based Repayment" is any arrangement**, inclusive of Income Share Agreements,** in which the consumer's primary education financing payment obligation **(excluding deferral and forbearance payment opportunities)** is based upon the consumer's income or employment status. **For the avoidance of doubt, no Income-Based Repayment arrangement will be considered an "Income-Based Advance" under this subdivision unless such arrangement specifically meets the definition of "Income-Based Advance" as defined herein**."*

We would then recommend adding a definition of "Income Share Agreements" as follows:

> ***"Income Share Agreement" is any arrangement in which the consumer's education financing payment obligation is (1) calculated, based upon, or determined by the consumer's income, (2) the consumer only incurs an obligation in each payment period if the individual's income in that period is above an income threshold specified in the agreement, (3) there is a contract duration after which the obligation is complete regardless of how much has been paid, as long as the consumer has paid any prior amounts due, and (4) each of these elements is available at the time of contracting.***

In summary, we believe that income-based contracts should incorporate both contingent payments and a maximum duration to be considered "income-based repayment."

B. Clarify the distinction between "Income-Based Advance" and "Income-Based Repayment"

While the proposed definitions of "Income-Based Advance" and "Income-Based Repayment" are sufficiently different textually, we are concerned that the similar phrasing may lead to consumer and market confusion and believe that a clear stipulation that the two are facially separate and distinct would improve the clarity of the proposed regulations. Our concerns are further exacerbated because the colloquial market terminology of "Income Share Agreement" is not defined anywhere in the text. As such, we would request that the definition for "Income-Based Repayment" clearly state:

> *For the avoidance of doubt, no Income-Based Repayment arrangement will be considered an "Income-Based Advance" under this subdivision unless such arrangement specifically meets the definition of "Income-Based Advance" as defined herein.*

II. INCOME SHARE AGREEMENTS ARE NOT SECTION 1461 ADVANCES NOR ASSIGNMENTS OF WAGES

A. ISAs are not Section 1461 Advances

ISAs should not fall into the definition of an advance as defined under Section 1461, as we believe the description therein fundamentally misunderstands the purpose and scope of Income Share Agreements. As we read the proposed rule, Income Share Agreements fall outside of the plain text definition of Income-Based Advance, where the DFPI's proposed definition requires that, amongst other requirements, such an advance be "based on income that has accrued to the benefit of the consumer but has not, at the time of the advance, been paid to the consumer" and "collection in a single payment on a date within thirty-one (31) days", neither of which at all describe an Income Share Agreement or Income-Based Repayment arrangement. Additionally, any interpretation of a 1461 Advance that included ISAs within that definition would simultaneously capture traditional private student installment loans under Regulation Z in such a definition–something we believe is outside of the Department's intent.

B. ISAs are not "Assignments of Wages"

The "Initial Statement of Reasons" asserts that "income share agreements are, for all practical purposes, an assignment of a portion of the consumer's wages or earnings" and "liberal interpretations of law relating to the sale or assignment of wages applies equally to income share agreements." The assertion that ISAs are inherently an assignment of wages conflates two distinct types of contractual arrangements, is at odds with the plain text of existing statutes and regulations and would potentially be harmful to consumers.

"Assignment of wages" is terminology that has specific legal meaning.[1] Across all jurisdictions the term generally refers to borrowers assigning and creditors legally obtaining the right to garnish or seek wages directly from an individual's employer as a means of preempting payment of wages to the individual from their employer.[2] This is not inherent to or a common feature of an Income Share Agreement. To our knowledge, no Income Share Agreement provider in the United States includes such language in their borrower agreements. With an Income Share Agreement, in contrast, a borrower's monthly payment amounts are indexed to–calculated as a function of–the borrower's current income level at the time a given payment becomes due. Nothing about the process of indexing payments to income requires that a borrower assign their wages.

In conflating these two concepts, we fear that the proposed rule will create market confusion between two very distinct arrangements – one (ISAs and indexing payment amounts to income, generally) that is designed to be a consumer protection and affordability measure, and another (assignment of wages) that is a measure where consumer's yield many of their rights with respect to their earned wages. As a result, unscrupulous providers may take advantage of this confusion to require that borrowers assign their wages.

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[1] Cal. Lab. Code § 300, "'assignment of wages' includes the sale or assignment of, or given of an order for, wage or salary….".

[2] See, e.g., Cal. Lab. Code §§ 300(b)(7) contemplating that assignments of wages are filed with the debtor's employer and 300(c) ("Under any assignment of wages, a sum…shall be withheld by, and be collectible from, the assignor's employer at the time of each payment of such wages or salary.")

Additionally, if interpreted literally, the statement that "income share agreements are, for all practical purposes, an assignment of a portion of the consumer's wages or earnings" largely because "such contracts would not be economically viable at scale if the most consumers did not ultimately pay back more than they owe" in the Initial Statement of Reasons is problematic because its language is so broad as to make any advance (not just an Income-Based Advance) an assignment of wages such that Sallie Mae, SoFi, Department of Education FSA loans, installment loans, etc. would all be assignments of wages despite the fact that none of them obtain the rights to such legal recourse. Private student loans, federal student loans, installment loans, etc. *all* are paid from "consumer's earned wages" and *all* are built upon a model where economic viability requires that "most consumers [...] pay back more than they owe."

C. Proposed changes

For the avoidance of doubt, we are not disputing the proposed regulatory treatment of advances with Income Based Repayment or Income Share Agreements as "loans" under Section 1461. But we strongly urge the Department to remove language from proposed regulations and the Statement of Reasons stating that ISAs are inherently an "assignment of wages." To conflate the two erodes the fundamental distinction between indexing an individual's payment amount to their income (as with ISAs or federal income-driven repayment plans)–an important tool for ensuring an affordable obligation–and a consumer contractually providing a lender access to the consumer's wages via an employer before the consumer is paid those wages (wage assignment).

III. AMENDING PROPOSED DRAFTING FOR SECTION 1466

A. Concerns with language as drafted

We appreciate the Department's clarifications in Section 1466 regarding the treatment of "Income-based Repayment" arrangements under the existing requirements of the California Financial Code. However, we have concerns regarding the precise language utilized, as it raises issues pertaining to implementation, the clarity of definitions, and the practical impact on both the market and consumers.

B. Proposed revision to 1466(a)

We recommend revising section 1466(a) as follows:

> ~~*A loan contract that provides the borrower with the option of making payments based upon a fixed percentage of the borrower's income*~~ ***An Income-Based Repayment loan contract*** *complies with the requirement in Financial Code section 22307, subdivision (b), that a loan contract "provide for payment of the aggregate amount contracted to be paid in substantially equal periodical payments," if****, as of the effective date of each contract, the contract provides the borrower with a predefined formula for calculating each payment during the term of the contract where the only unknown variable as of the effective date of each such contract is the income of the borrower at the point of calculation of each payment.*** ~~*the contract also provides the borrower with the option of making substantially equal periodical payments.*~~ *For a contract described in this*

subdivision, a payment based upon ***an Income-Based Repayment loan contract*** ~~*fixed percentage of a borrower's income*~~ *shall not be considered a balloon payment under Section 1453 of these rules.*

The proposed language raises a significant concern due to its requirement for lenders to provide an ambiguous "option" within a single contract. The main issue revolves around the lack of clarity regarding whether the option to make "substantially equal periodic payments" is a one-time choice, either at the contract's origination or at a later stage, or if it is a perpetual choice available throughout the contract's lifespan. Both interpretations are likely to lead to undesirable outcomes for consumers.

If the option must be provided only once, it forces the lender to offer two distinct products within a single contract: one that is an Income-Based Repayment loan and another that is not. Although this choice would typically be presented at the contract's origination, the resulting agreement, as per the proposed rule, would need to describe and disclose the terms of both options, even though the option would not continue to exist during the contract's duration. Implementing such a requirement is impractical and is likely to confuse consumers.

On the other hand, if the option is perpetual, it would create an information asymmetry that only benefits consumers, enabling them to switch between terms in their favor. However, this unintended consequence may lead some lenders to set the traditional installment option at artificially high maximum implied APRs (implied through inflated periodic payment amounts) to discourage consumers from switching between terms.

In either case, the requirement to provide the option would not result in a beneficial outcome for consumers. Instead, we propose the language above, which offers consumers of Income-Based Repayment contracts the predictability of substantially equal periodic payments with clearer implementation.

Finally, leveraging the existing, defined "Income-Based Repayment" terminology will help avoid confusion across consumers and market participants.

C. Proposed revision to 1466(b)

We recommend revising 1466(b) as follows:

A loan contract that does not require a borrower to make payments while the borrower is obtaining a postsecondary education or for a ***predefined fixed grace*** *period* ~~*of six months*~~ *after completion or termination of a postsecondary education, as that term is defined in subdivision (f) of Section 1003 of subchapter 4 of these rules, complies with the requirement in Financial Code section 22307, subdivision (b), that the first payment be made not "more than one month and 15 days from the date the loan is made," if the*

loan contract ***is an Income-Based Repayment education loan.*** ~~*does not accrue charges during the period in which the borrower is not required to make payments.*~~

Many programs funded via Income-Based Repayment arrangements support borrowers attending programs that are six months or less. Mandating that lenders offer six-month grace periods for programs that are themselves shorter than six months is antithetical to the consumer purpose behind such programs–to learn, obtain employment, and meet their obligation quickly–and will likely increase costs of borrowing as lenders need to cover non-payment during that prolonged grace period. Stipulating that the contract must offer a 'predefined' and 'fixed' grace period achieves the same regulatory goal without these risks.

Second, the pre-existing text for Financial Code section 22307, subdivision (b), already excludes "student loan[s] made by an eligible lender under the Higher Education Act of 1965." While we believe that the CFPB and U.S. Department of Education have clearly defined income share agreements as a type of "private education loan" under the Higher Education Act of 1965,[3] there are still questions as to the breadth of applicability of such non-rulemaking actions, and we have concerns that gaps in the defined terminology used by those federal regulators and the DFPI could result in that exclusion not being also equally and appropriately applied to Income-Based Repayment arrangements under these new regulations. It is for these reasons that we request the revision to the final clause of Section 1466(b) above.

Alternatively, if the Departments opts to use the language as currently drafted, we urge the Department to provide clarity related to the definition of "accruing charges." For example, ISAs generally do not accrue an obligation until the individual earns above the income threshold in a given payment period and only in such payment periods.

IV. CONCLUSION

We once again appreciate the DFPI's leadership on these important topics and the opportunity to submit comments related to PRO 01-21 - Notice of Proposed Rulemaking Under the California Consumer Financial Protection Law and the California Financing Law, California Deferred Deposit Transaction Law, and California Student Loan Servicing Act.

We continue to believe that income-contingent, income-indexed tools such as Income Share Agreements are essential to expand students' access to postsecondary education in affordable and flexible ways despite the ever-growing underlying costs of such education. It is for this reason that we feel it is essential to make the requested clarifications and revisions suggested herein to ensure that

[3] *See, e.g., In re: Better Future Forward, Inc.*, Consent Order, No. 2021-CFPB-005 (Cons. Fin. Protection Bureau, Sept. 7, 2021) ("ISAs are 'private education loans' under Regulation Z…."); U.S. Dept. of Educ., *Income Share Agreements and Private Education Loan Requirements*, GENERAL-22-12 (March 2, 2022) (adopting the CFPB's language and reiterating responsibilities of educational institutions and institution-affiliated organizations).

Income-Based Repayment arrangements and the lenders that offer them are regulated in the same way that other private student lenders are in the State of California.

Thank you again for this opportunity to comment. We welcome any questions you may have regarding this submission.

Sincerely,

Better Future Forward, Inc.
Jobs for the Future
Stride Funding Inc.
Social Finance, Inc.