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To whom it may concern:

This letter provides commentary regarding the proposed adoption of new regulations of earned wage access (EWA) providers in California, as due by May 17, 2023:

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 PRO 01-21

This comment will not concern specific definitions or regulations but will instead provide analysis of costs and benefits of EWA on consumers and how the optimal design of such systems is not one-size fits all. I also comment on the misuse of APR as a measure of the cost of EWA.

Highlights:

- EWA benefits workers by smoothing their access to pay and allowing them to smooth consumption. This is not true for payday loans, whose benefit is the same as any other loan.
- Smooth consumption is directly beneficial for workers in several important ways. These ways have been analyzed in my own published research as well as that of others. Smooth consumption reduces feast-famine consumption cycles, bingeing, malnutrition, and property crime.
- Using an annual percentage rate (APR) to measure the cost of EWA is incorrect, as it compares a cost that is ratio with a benefit that is a dollar value. This is not the case for

term loans or frequently renewed payday loans, both of which have costs and benefits that are well measured with ratios.

My background:

I am a Full Professor at the Leeds School of Business, University of Colorado Boulder, with a specialty in finance. I received my PhD in economics from Stanford University in 2007 and have performed research as an academic in the years since. Further information about my background and research can be found on my website, here: <https://sites.google.com/site/edvanwesep/home>. Most pertinent to this proposed regulation is my work on the timing of pay. Along with my co-author Christopher Parsons, I published the first and, to my knowledge, only theoretical exploration of optimal pay frequency and the effect of EWA on consumer welfare, titled *The Timing of Pay*. References to published work can be found at the end of this letter.

Our paper was written in the years 2010-2012 and published in 2013. It therefore predates the arrival of EWA providers. Far from its results being derived to benefit these firms, they helped motivate the founding of at least two of these firms. In presenting our work, we were often asked variants of the question “If what you say is true, why are there no financial firms that provide earned wage access?” We could only say that there ought to be. Now there are.

Critical results from theoretical work:

- The assumption driving our work is that many consumers are present biased, meaning that they have much higher discount rates from today to tomorrow than from a day in the future to the following day. There is enormous evidence that consumers are present biased and for the sake of brevity I will not summarize that literature here. A google scholar search will provide a wealth of research on the topic. The implications of present bias are myriad, but the most critical for EWA is that people have difficulty saving over the course of a pay period. The problem is small if people are paid frequently but becomes serious as their pay is increasingly infrequent.
- When consumers are present biased, we show that they will tend to over-consume soon after receiving a paycheck and be left with little money prior to the next paycheck. Under consumption is much more painful than overconsumption is pleasurable, so this feast-famine pattern of consumption is, overall, bad for consumers. They would be better off if their consumption were smoother. This means that consumers whose paychecks are more frequent are better off than those whose paychecks are less frequent, *even if the average pay over the course of a month is the same*. You cannot simply look at a consumer’s average pay if you want to understand her wellbeing.
- Our results establish a trade-off between how often workers are paid and the level of pay that they receive. Specifically, we assume that they must pay a fixed fee for every paycheck and ask how often they would like to be paid as a function of that fixed fee. The higher the fee, the less often they would like to receive their pay. What workers will be willing to pay to have more frequent pay depends, of course, upon the worker, but we use plausible estimates of present bias from the data to show that a typical worker would probably be equally well off being paid (i) every two weeks, or (ii) every week but with a fee of about 1.5% per paycheck.
- We also show that unregulated payday lending is unambiguously bad for present-biased workers. It does not help workers smooth their compensation – it moves consumption earlier, but at enormous expense. Pay smoothing is valuable. Pay advances are not.

Implications for regulation in practice:

- The most important takeaway from the paper is that *it is best to pay workers when they need the money*. For a typical worker with monthly rent and loan payments, this probably means some money that comes in large lumps around rent and loan payment due dates. It also means smooth pay the rest of the time to cover frequent expenses like food, bus fares, and small bills.
- The current practice of paying workers in large lumps is almost certainly not ideal. This is, of course, why many states define pay periods that differ based on a worker's job, as we document in Tables 2 and 3. Workers would be better off with smoother pay.
- Practically speaking, large lumps of periodic pay also cause financial fatigue, in which effort that goes into managing money (i.e., assuring that money is available for when large payments are due) eventually leads to bad decisions both with finances and elsewhere in life. Delivering pay to workers when they need the money relieves this stress and improves financial decision-making elsewhere.
- The key benefit of EWA as opposed to payday loans is that earned wages are smooth. A worker who works eight hour shifts five days a week accumulates pay daily. If that worker has access to that pay in real time, her pay will be smooth over the course of the pay period.
- Smooth pay allows for smooth consumption which reduces the likelihood/opportunity of bingeing on payday. It also reduces the likelihood of serious harm to the worker or those around her. Foley (2011) finds that crimes motivated by money are more frequent at the end of a welfare payment cycle: as recipients run out of money over the course of the month, some turn to crime to supplement income. Shapiro (2005) finds that nourishment decreases over the month following a welfare payment. Smooth pay means smooth, easy-to-plan consumption and avoidable periods in which one might turn to crime or suffer malnourishment.

Caveats when implementing EWA

- There are some caveats in doing EWA correctly. An important one is that it must allow wages to be smoothed. The more that EWA resembles payday loans – where the primary effect is to move consumption forward in time, not to smooth consumption – the more skeptical we should be.
- There should be a mechanism rewarding workers who leave large lumps in their accounts. Optimal pay timing matches workers' consumption needs. Those needs are often lumpy, as in the case of rent. If workers access too much pay too early, then they may have trouble meeting rent.

Measuring the efficacy of EWA

- In assessing the welfare effects of pay smoothing, it is not simply enough to calculate APRs and compare them to long-term loans or payday loans.
 - We should expect a present-biased consumer to take out a payday loan as early as possible. If payday loans are available six weeks before payday, for example, then many present-biased consumers will take out those loans six weeks early, even if effective interest rates are high. Those consumers would then roll over loans as they come due. These loans would not do anything to smooth pay – they would

just move pay forward in time, so over the course of a year they act in almost precisely the same way as a long-term interest-only loan. This means that, if an APR is a good way to measure the cost of a long-term loan, then an APR is a good way to measure the cost of a payday loan. Section 5.1 of our paper makes this precise.

- An APR is the right measure of cost for a long-term loan or renewing payday loans. We might say, for example, that it can be reasonable for a consumer to borrow money even if the loan repayment one year hence is 30% more than the initial amount lent. It is likely not reasonable if the repayment is 350% more than the amount lent. The dollar value of the loan matters, but a comparison of two ratios – a discount rate and an interest rate – is a reasonable starting point. You can also compare dollars to dollars by multiplying both the discount rate and the APR by the loan amount.
- EWA is not about getting money now in exchange for money later. Even if a worker uses EWA every single pay period, the effect on welfare is not remotely similar to the effect of a long-term interest-only loan or renewable payday loan. Imagine a worker who accesses pay every day in real time. The main effect of this EWA is to allow the worker to smooth her pay and therefore smooth her consumption. As such, an APR is not a correct measure of the cost of EWA. Instead, the correct measure is to compare the cost (over a pay period, month, quarter, or year) of wage access, measured in dollars, and compare it to the cost of feast-famine consumption, measured in dollars.
- Put another way, using APR, a percentage, to measure the cost of EWA is similar to using an odds ratio to measure the benefit of a medical treatment. If a treatment costs \$10,000 and reduces the likelihood of some adverse health event by 50%, this information does not actually help us answer the question of whether the treatment is worth it. Is the likelihood of the event normally one-in-a-billion? Is the harm similar to the harm of the common cold? In either case, the benefit is much less than the cost. A ratio is not the right measure of benefit or cost when it is compared to a dollar value.
- To determine whether EWA is beneficial for workers, given that APR is not a good tool, I suggest four methods.
 - Observe the actual usage of EWA: Do workers tend to withdraw all pay as it is earned? Or do they often leave large lumps for payday? Some combination of the two is ideal.
 - Observe measures of financial distress: Are workers with access to EWA more or less likely to become delinquent or default on loans, rent, or other tradelines?
 - Compare the total per-period (e.g., quarterly, annual) dollar expense of EWA to the worker's wage. This ratio is a good measure of the cost of EWA as compared to the benefit. The maximum ratio consistent with EWA benefitting workers is larger when their pay periods are longer.
 - Allow workers to opt in: Most workers understand themselves. If they are likely to harm their future selves using EWA, they won't be likely to sign up for it. When people are present biased they will knowingly overconsume today, but they also want to constrain their future selves, at least to some extent. They can do so by not signing up for a program that offers the opportunity for self-abuse. Similarly, one can sign up for a retirement savings plan to encourage a future self to save more (see Laibson, 1997; Laibson *et al*, 1998). Importantly, this won't

work for payday loans. A payday loan gives access to money *today*. It will tend to be abused.

References:

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