San Francisco, May 11, 2023

Comment to the California Department of Financial Protection and Innovation (CA DFPI) regarding the proposed regulation PRO 01-21; that advances of funds to be repaid from a consumer's future earned or unearned pay is a loan subject to the California Financing Law (CFL).

In 2021, I co-authored a paper that analyzed the impact of Earned Wage Access (EWA) on household financial well-being.[1] The analysis took the perspective of the user and built on an extensive and broad review of previous research on the impact of pay frequency on savings, spending, and financial well-being. My co-author and I evaluated potentially positive and negative effects of EWA.

EWA is best evaluated from the perspective of how timing and frequency of pay impacts household spending patterns. Households are often thought to keep spending at consistent levels, even as pay is infrequent, through credit. For households that lack access to low-cost credit (such as 30-day, 0% APR credit cards), the ability to access earned wages provides an affordable alternative to other means of managing cash-flow – such as payday loans, or bank overdraft fees.

Lower-income households that that lack access to affordable consumer credit are likely to be a significant fraction of EWA users. Not only are lower-income households likely to face higher costs of credit, but the overall cost also constitutes a much larger fraction of their overall income compared to higher-income households. The cost of credit to manage spending between paychecks can be considered a direct cost of managing household liquidity that EWA has the potential to substantially decrease, and therefore provides a net benefit to users.

In our report, we also consider what we define as in-direct costs of managing liquidity, that constitute negative short- and longer-term consequences of decisions that households make due to liquidity considerations. These decisions would not have been made in a frictionless setting without cost or constraints on borrowing, or if earnings where immediately accessible.

In-direct costs has been given little attention in prior evaluations of EWA. Two examples of in-direct costs would be:

1) Households facing an unexpected expense and lack access to savings or credit, and therefore resort to strategic non-payment of a bill to manage liquidity.[2] Besides the direct cost of having

[1] See, Donner, H, and Sciliano, D. 2021. The Impact of Earned Wage Access on Household Financial Wellbeing. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4007632

[2] Strategic non-payment of bills as a means of managing liquidity is not uncommon. In 2019, 12% of surveyed U.S. households stated that they would be unable to pay all their monthly bills if faced with an unexpected expense of $400, i.e., they would resort to strategic non-payment of other expenses. See Federal Reserve. 2020. Report on the Economic

to pay a late fee, the non-payment also negatively impacts the individual's credit score, and hampers their ability to get access to credit in the future. These are in-direct consequences of lacking access to credit or earned wages and are likely to be among the costliest ways of managing liquidity.

2) Liquidity constraints might also influence how individuals spend their time. Individuals can manage their liquidity by taking on additional work, such as through increased hours on their regular job(s) or by working through gig-economy platforms. If one job offers immediate payment, while another does not, someone who is in immediate need for cash might engage in work that pays less, resulting in a very high discount rate compared to waiting 2 weeks for a paycheck from a higher-paying job. Similarly, if one job offers better career and skills development, but does not offer immediate pay, the consequences of choosing the job that offers immediate pay are potentially very harmful. EWA has the potential to remove pay frequency as a consideration when deciding on what work to engage on.

The above illustrates that EWA has the potential to provide significant and positive effects on users. EWA fees, and their implicit APR, also needs to be considered relative to very high in-direct costs of managing household liquidity that many households face.

The positive effects on household financial well-being requires that EWA is designed appropriately to mitigate the wealth-effect that some users might experience. As increased pay frequency or access to earned wages increases an individual's perception of wealth, it might increase spending and result in financial hardship. My understanding is that EWA providers are aware of this, and often bundle their tools with solutions for budgeting and financial planning, in addition to limiting the fraction of earned wages that are accessible (typically 50 to 60 percent). The pervasiveness of these potential negative effects needs to be evaluated further. One aspect that is interesting, is the potential for EWA to serve as a tool that not only provides access to earned wages, but also increases financial literacy when bundled with budgeting solutions, and results in access to financial services that underbanked users might have previously lacked access to.

Empirical studies that evaluate the impact on EWA are needed. EWA is likely to have an impact that varies considerably both across user characteristics, and depending on how it is designed. It is unlikely that a uniform conclusion that applies to all users and all forms of EWA is appropriate. However, that EWA increases employee satisfaction and retention, indicates that the positives often outweigh the negatives.[3]

Well-Being of U.S. Households in 2019 - May 2020. https://www.federalreserve.gov/publications/files/2019-report-economic-well-being-us-households-202005.pdf

[3] It is possible that EWA both increases satisfaction and is harmful, but a more likely deduction is that that employee demand for EWA supports that it results in better financial outcomes.

As also noted in the report, EWA is not a substitute for budgeting and saving, and cannot solve financial hardship caused by having too many expenses and too little income. However, for the fraction of low-income households that lack access to cheap credit, appropriately designed EWA can decrease both direct and in-direct costs of managing liquidity and therefore have a positive effect on financial outcomes. Many U.S. households are unable to manage unexpected expenses of a few hundred dollars without resorting to some form of credit or strategic non-payment, in addition to having to make decisions and trade-offs they would not have had to make in a setting where earned wages could be accessed.

Even as future research should inform both industry practices and regulation, I believe that it would be very unfortunate not to consider the potentially positive impact that EWA can have on the financial well-being of users, by equating EWA to credit and making it subject to the regulatory burdens of CFL.

It is noteworthy that the proposal does not distinguish between payment of earned wages and advances of unearned wages. Payment of earned, but unpaid wages, does not meet the definition of credit.

Sincerely,

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