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May 5, 2023

Department of Financial Protection and Innovation
Attn: Araceli Dyson
2101 Arena Boulevard
Sacramento, CA 95834

Subject: Comments on PRO 01-21 Released March 17, 2023

To Whom It May Concern:

Thank you for the opportunity to comment on the proposed regulations. I appreciate the Department's willingness to accept some of the suggestions I offered in my comment letter dated December 15, 2021. However, I am extremely concerned about the Department's new proposal to apply provisions of the California Financing Law (CFL) to the product the Department is now calling "income-based advances." I also believe that the proposed regulation would benefit from additional clarification in select locations. My comments and suggestions are organized by topic, immediately below.

CONCERNS REGARDING THE APPLICATION OF THE CFL TO INCOME-BASED ADVANCE PROVIDERS

In its March 17, 2023 revision of PRO 01-21, Department is proposing something it has never previously proposed in connection with this regulation: calling income-based advances loans subject to the CFL; regulating providers of income-based advances as lenders under the CFL; and subjecting income-based advances to the provisions of the CFL that govern allowable charges under that law. I am *deeply* concerned about this new approach for both conceptual and practical reasons, and I urge the Department to withdraw this portion of its proposal in favor of an alternate approach. Specifically, I urge the Department to withdraw its proposed addition of Sections 1461, 1462, 1463, 1464, and 1465 to Article 4 of Subchapter 6 of Chapter 3 of Title 10 of the California Code of Regulations in favor of codifying an extensive number of income-based advance industry best practices within a new section of Article 1 of Subchapter 4 of Chapter 3 of Title 10.

The Department's Proposed Approach Fails to Reflect the Department's Desire to Foster Responsible Innovation Among Consumer Financial Service Providers

As discussed below, the Department's proposed approach contains myriad procedural and operational flaws. However, much more significantly, its approach makes a mockery of the

Department's responsibility to support and appropriately regulate responsible financial innovation. When the California Consumer Financial Protection Law (CCFPL) was proposed by the Newsom Administration in 2020, it was characterized as a law that sought to protect consumers and to foster innovation. One of the four guiding purposes of the CCFPL (Section 90000(b)(4)) is "promoting nondiscriminatory consumer-protective innovation in consumer financial products and services." Because promoting consumer-protective innovation was viewed as a key role of the Department, the Newsom Administration chose the Department's name carefully; it is not the Department of Financial Protection, but rather the Department of Financial Protection *and Innovation* (emphasis added). Furthermore, when the CCFPL was being debated by the Legislature during 2020, both the Department and the Newsom Administration repeatedly argued that the Department needed the authority to regulate providers of consumer financial products and services in a more flexible way than California's existing financial services laws allowed. Their argument was "there are a lot of new, innovative consumer financial products and services being offered in California, which don't fit neatly within the licensing laws drafted multiple decades ago. Rather than trying to squeeze these innovative offerings into our existing licensing regimes, the Department should have the authority to promulgate new, unique regulatory regimes specific to these innovative products."

As the Department and Administration described it and the Legislature understood it during 2020, the Department planned to use its new authority to identify innovative industries it believed were worthy of additional oversight; collect data from the industry participants to inform the Department's regulatory approach; and then propose registration requirements for these industries in a manner that promoted consumer protection, while reflecting the unique and innovative nature of the industries it sought to regulate. Consistent with that vision, the Department entered into memoranda of understanding with several providers of income-based advances during 2021, through which it collected a significant amount of data. And yet, after collecting over two years' worth of data, the most innovative approach the Department can come up with is "try to squeeze your business model into provisions of an installment loan law whose provisions are over fifty years old." How does this approach promote consumer-protective innovation?

Far from promoting innovation, the Department's proposal sends a message to financial innovators that, regardless of the Department's name and regardless of the Department's authority to craft industry-specific rules, the Department intends to look no farther than its existing licensing laws for its menu of regulatory options when regulating innovative providers of financial products and services. That approach is not only short-sighted, but it renounces California's opportunity to be the nation's most responsive and innovative consumer protection regulator in favor of the outdated status quo.

As I describe below, I believe the Department could do a far better job of promoting consumer protection *and* fostering innovation if it sought to codify existing best practices in use among responsible industry participants. Trying to force income-based advances into a decades-old installment loan law will do more harm than good.

The Department's Proposed Approach is Confusing in the Extreme

Beyond the conceptual concerns noted above, the Department's proposal poses myriad practical problems, the most significant of which is its lack of clarity; simply put, the Department's proposal is unclear and confusing in the extreme. The core element of the Department's proposal requires that "the charges collected by the provider in connection with each income-based advance do not exceed charges that would be permitted under the CFL if the provider were licensed under that law." However, as shown below, it is entirely unclear which sections of the CFL the Department is seeking to apply to providers of income-based advances, and which sections of that law would be inapplicable under the proposal. A plain reading of the CFL provides little guidance on these questions, because income-based advances are so vastly dissimilar from the installment loans regulated under that law.

In an effort to demonstrate the lack of clarity created by the Department's current proposed approach, I have listed below those sections of the CFL that relate to allowable charges in connection with unsecured loans in amounts below $2,500. I limited my review to those sections, because all of the income-based advances that are the subject of the Department's proposal are unsecured and provided in amounts far below $2,500.

Financial Code Section (FC) 22303: A provider may contract for and receive charges at a rate not exceeding 2.5% per month on the unpaid principal balance of an advance of up to $225. Appears to apply to income-based providers.

FC 22304: As an alternative to the rate in FC 22303, a provider may charge a rate not exceeding 1.6% per month or a rate not exceeding 5/6^{ths} of one percent plus 1/12th of the federal discount rate prevailing on the 25th day of the second month of the quarter preceding the quarter in which the loan is made. Because the 2.5% per month allowable under Section 22303 exceeds both of the alternative rates allowable under FC 22304, this section is unlikely to be relevant. However, it appears to apply to income-based advance providers.

FC 22305: A provider may charge an administrative fee equal to the lesser of 5% of the principal amount or $50. Appears to apply to income-based advance providers.

FC 22307: A provider must compute charges on loans on the basis of the number of days actually elapsed. Application to income-based advances is unclear.

Loans must be repaid in equal, periodic installments. Does not apply to income-based advances pursuant to proposed Section 1463.

FC 22307.5: A provider may not charge a prepayment penalty. Appears to apply to income-based advance providers.

FC 22308: Application to income-based advances is unclear.

FC 22309: Application to income-based advances is unclear.

FC 22310: A provider need not provide a rebate or refund in an amount less than $1, except in connection with an administrative, civil, or criminal action. Appears to apply to income-based advance providers.

FC 22311: Application to income-based advances is unclear.

FC 22312: Application to income-based advances is unclear.

FC 22313: Application to income-based advances is unclear.

FC 22314: Application to income-based advances is unclear.

FC 22315: Application to income-based advances is unclear.

FC 22320: A provider may charge a fee of up to $15 for a dishonored check, negotiable order of withdrawal, or share draft (i.e., an insufficient funds fee). Appears to apply to income-based advance providers.

FC 22321: A provider may charge a delinquency fee of up to $10 for a period in default of ten days or more or up to $15 for a period in default of 15 days or more. Appears to apply to income-based advance providers.

FC 22322: Application to income-based advances is unclear.

FC 22323: Application to income-based advances is unclear.

FC 22325: Application to income-based advance providers is unclear, as most operate entirely online.

FC 22332: A provider must disclose the amount and length of each advance and the agreed rate of charge or the annual percentage rate pursuant to Regulation Z at the time an advance is made. Appears to apply to income-based advance providers, but as discussed further below, its application is unclear.

Not only has the Department failed to clarify which of the aforementioned sections of the CFL it expects providers of income-based advances to follow, but it has also failed to clarify *how* it expects providers of income-based advances to comply with these sections. For example, how frequently may a provider of income-based advances charge an administrative fee? Every time it advances money to a customer? May a provider consider each advance as a separate loan for purposes of calculating a delinquency fee? Must a provider disclose a separate APR for each advance, even though the APR across a single pay period that includes multiple advances will be a blended average that fails to match any of the disclosed APRs? How is an income-based

provider supposed to account for the period of time between when funds are advanced to a consumer and when a consumer actually receives those funds when calculating charges and APRs?

The Department's Proposed Approach Fails to Codify Pro-Consumer Industry Best Practices

Beyond its lack of clarity, the Department's proposed approach appears to equate rate caps with consumer protection. By taking such a simplistic and incomplete approach, the Department has missed an opportunity to codify myriad best practices that income-based advance providers are currently following. Although there is a wide range of business models currently in use (reflective of the relative youth and innovative nature of the industry), all industry providers *currently* adhere to the following best practices:

- Before entering into an agreement with a consumer for the provision of income-based advances, the provider provides the consumer with a written document that clearly, conspicuously, and in language intended to be understood by a layperson, informs the consumer of his or her rights under the agreement and discloses all fees associated with the services covered by the agreement.
- Before making any material changes to the terms or conditions of that agreement, the provider clearly, conspicuously, and in language intended to be understood by a layperson, informs the consumer of those changes before implementing them for that consumer.
- Each provider offers each consumer at least one opportunity per pay period to receive an advance of funds at no cost to that consumer and clearly, conspicuously, and in language intended to be understood by a layperson, informs the consumer how they may elect this option.
- Before advancing proceeds to a consumer, each provider verifies that the consumer has already earned at least as much money during that pay period as they are requesting.
- Providers do not unilaterally decide how a consumer will receive advances. Instead, the decision on how to provide the advance is done on a mutually agreed upon basis.
- Providers provide proceeds on a non-recourse basis. In practice, this means that providers do not seek to compel repayment of advances or of fees through repeated attempts to debit a consumer's depository institution account in violation of applicable payment system rules, use of outbound telephone calls to attempt collection from the consumer, use of or threatened use of a civil suit against the consumer, use of a third party to pursue collection from the consumer on the provider's behalf, or sale of outstanding advances to a third-party collector or debt buyer for collection from the consumer.
- In keeping with the non-recourse nature of their product, providers allow consumers to opt out of their participation in income-based advances at any time and without financial penalty for doing so.

- Providers do not base the size of an advance for which a consumer is eligible or the frequency with which a consumer is eligible to receive an advance on the amount of a fee or gratuity paid by that consumer to the provider.
- Providers do not charge late fees, deferral fees, or other penalties or charges for failure to pay outstanding proceeds or other fees.
- Providers do not accept payment from consumers via credit card.
- Providers do not require a consumer's credit report or credit score to determine a consumer's eligibility for income-based advances.
- Providers do not report a consumer's payment or failed repayment of advances or fees to a consumer credit reporting agency.

Significantly, and disappointingly, despite collecting extensive amounts of operational data from providers, and despite knowing that all of the aforementioned consumer protections are in current use by providers, the Department failed to include any of them in its proposed regulations. I strongly believe that consumers would be better protected in their interactions with income-based advance providers if the Department were to codify these existing best practices in lieu of its current, CFL-focused approach. Codifying these best practices will ensure that they continue to be used by existing providers and that they represent the minimum standard of practice among new industry participants.

The current, overly confusing "rate cap only" structure is ill-conceived and insufficient. Consumers would be *far* better protected if the Department proposed a regulation that is tailored to the industry, rather than trying to squeeze an innovative, relatively new industry into an antiquated lending law designed for financial products that bear no similarity to the income-based advances the Department is seeking to regulate.

The Department's Proposed Approach Lacks Flexibility in Its Approach to Subscription Fees

As the proposed regulation is currently written, the only type of subscription fee contemplated is a monthly subscription fee. What about subscription fees that are imposed on a different frequency, such as per pay period? Are these allowed? If so, what rules apply to them? Why are subscription fees treated differently than all other types of fees that providers may charge? What is the basis for the $12 per month cap on subscription fees, when none of the other types of allowable charges are subject to specific caps? When disclosing an APR to a consumer for their transaction, what percentage of a subscription fee should be included as a "loan charge" associated with the advance?

The Department is Failing to Acknowledge or Reflect that Income-Based Advances Differ From Traditional Loans

As noted above, all income-based advance providers offer their customers at least one method to obtain advances free of charge. For some providers, advances are free if the consumer agrees to accept the advance on a provider-issued debit card. For other providers, advances are free if the

consumer agrees to receive the money within two to three business days of request, rather than on an expedited basis. Still other providers offer advances free of charge, but encourage consumers to tip what they believe is fair. The range of business practices varies significantly, but every income-based provider currently operating in California offers their customers at least one opportunity per pay period to obtain advances free of charge, and some providers offer free advances multiple times per pay period.

All income-based advance providers are also offering their advances on a non-recourse basis. If at any point in time after a consumer receives an advance, that consumer opts not to repay the advance, the provider is *contractually obligated* to refrain from pursuing that consumer to collect unpaid amounts. Certainly, a provider will be reluctant to continue extending new advances to a consumer who has failed to repay outstanding amounts, but providers do *not* pursue collections using any of the methods summarized in the best practices section above.

It is because of these two unique elements of income-based advances that I disagree with the Department's decision to characterize them as loans. They are simply unlike any other "loans" regulated by the Department; calling them loans and lumping them together with installment loans subject to the CFL fails to acknowledge their unique and consumer-friendly characteristics.

Requiring Disclosure of Annual Percentage Rates (APRs) is Less Helpful to Consumers Than Requiring Disclosure of Actual Costs

Through its commercial financing rulemaking process, the Department has received hundreds of pages of comments regarding the limitations of disclosing APRs to consumers and small businesses. In the interest of space, I will not attempt to repeat those arguments here. Instead, I will assert that consumers will be far better equipped to understand the cost of an income-based advance, and to understand its cost relative to other options readily available to and under consideration by that consumer, if income-based providers are required to disclose the dollar cost of advances provided to consumers rather than a series of APRs to that same consumer.

If a consumer is deciding whether to obtain an income-based advance in lieu of risking an overdraft fee at their depository institution, a late fee on their rent, or a late fee on another bill, that consumer will want to know the dollar cost of their income-based advance for comparison purposes. An APR doesn't help the consumer in this context, because the consumer doesn't have APRs for the items of comparison. Which is less expensive? An income-based advance or an overdraft fee? An APR can't answer that question, but a dollar cost can.

Consumers who seek out income-based advances are not seeking to compare these advances to longer-term loans; they are seeking to obtain a portion of their paychecks a few days earlier than payday. An APR is useful only as a tool to compare different financing options. In the case of income-based advances, there are no different financing options under consideration. The consumer simply wants to understand how much the advance will cost in dollars and cents.

SUGGESTED CLARIFICATIONS

In addition to the issues raised above, there are a handful of locations in the proposed regulation where further clarification would be extremely beneficial. These suggestions apply, irrespective of the ultimate direction the Department takes with respect to the regulation of income-based advances.

- Paragraph 4 of proposed Section 1022 ("Supplemental Information – General") requires "a list containing the addresses of all branch locations from which the applicant will offer or provide subject products to California residents." Because many of the entities that will be applying for registration operate entirely online, I suggest that the Department revise paragraph 4, as follows: "A list containing the addresses of all branch locations, ***if any,*** from which the applicant will offer or provide subject products to California residents."

- Paragraph 5 of proposed Section 1022 requires "the applicant's gross income for the prior calendar year from subject products provided to residents of this state." As the Department knows, some providers of income-based advances charge subscription fees for a bundle of services that include advances and other services considered valuable to the providers' customers. At present, the regulations provide no clarification for how the Department wants providers to calculate the pro-rata share of gross income attributable to income-based advances, when those advances are provided as part of a bundle of services for which a periodic subscription fee is charged. Absent such clarification, different providers are likely to calculate their pro-rate shares differently, which will render the information collected by the Department pursuant to this paragraph 5 useless for comparison purposes.

  Guidance regarding the Department's preferred method for calculating pro rata gross income attributable to income-based advances when a subscription fee is charged for a bundle of services will also help improve the quality of data the Department collects under subdivision (b) of Proposed Section 1041 ("Annual Reporting – General").

- Paragraph (2) of subdivision (c) of proposed Section 1045 ("Annual Reporting – Income-Based Advances) requires providers to calculate the average length of time between when each income-based advance was made and each advance's collection date. The terms "was made" and "collection date" are subject to multiple interpretations. In the interest of clarity, I suggest revising this paragraph to request that providers calculate the average length of time, in days, between when the provider initiates the transfer of an income-based advance to a consumer and the originally scheduled collection date associated with that advance.

- Paragraph (5) of subdivision (c) of proposed Section 1045 requests specific information related to obligor-based advances. However, as drafted, this paragraph fails to reflect the fact that some providers of obligor-based advances seek access to their customers' bank

accounts, in the event the provider has trouble collecting its advances via payroll deduction. To ensure that the Department collects information regarding attempts (if any) by providers of obligor-based advances to debit their customers' depository institution accounts, I recommend that the Department request similar information in paragraph (5) as the Department is requesting in Paragraph (4) – specifically, "the number of times, if any, in which the provider attempted to collect from the resident's bank account and the total amount collected from the resident's bank account."

Thank you for the opportunity to comment on the proposal. Please don't hesitate to reach out to me at [redacted] or [redacted] if you have any questions regarding this letter.

Sincerely,

Eileen Newhall, Owner
Eileen Newhall Consulting LLC