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Commissioner Clothilde Hewlett
Department of Financial Protection and Innovation
One Sansome Street, Suite 600
San Francisco, CA 94104

Re: Concerns with PRO 01-21 classification of "income-based advance" as a loan

Dear Commissioner Hewlett:

I include below comments on PRO 01-21 (the Proposal), which aims to enhance consumer protections under the California Consumer Financial Protection Law (CCFPL) and the California Financing Law (CFL) through registration requirements and rules that clarify the status of business activities, including income-based advances (IBA), which is also commonly referred to as earned wage access (EWA) by other policy stakeholders.

I am the William and Janice Terry Professor of Finance and Data Science at Santa Clara University, and previously held appointments as Professor at Harvard University and University of California, Berkeley. My fields are quantitative finance, theoretical computer science, and applied computer science. My CV is available at http://srdas.github.io/srdvita.pdf. I have previously been an advisor to Payactiv, a long-standing provider of EWA and financial wellness products. I have also served as a contractor with the Department of Justice and the Office of the California State Attorney General.

While the Proposal aims to cover a range of financial activities that engage with consumers, my comments will focus on EWA. The comments below are based on the following documents:

(i) Notice of Proposed Rulemaking: https://dfpi.ca.gov/wp-content/uploads/sites/337/2023/03/PRO-01-21-NOPA.pdf,

(ii)Text of Proposed Regulations: https://dfpi.ca.gov/wp-content/uploads/sites/337/2023/03/PRO-01-21-TEXT.pdf,

(iii) Initial Statement of Reasons: https://dfpi.ca.gov/wp-content/uploads/sites/337/2023/03/PRO-01-21-ISOR.pdf.

1. **PRO 01-21 is likely to increase costs for providers, which would cause consumer fees to increase and decrease competitiveness in the marketplace.**

The intention of the Proposal is to (i) increase protection to consumers, especially those who are financially vulnerable; (ii) do so by requiring provider registration and reporting requirements; (iii) designating EWA as a lending practice; (iv) while limiting costs to consumers. It is important to note that EWA is provided in coordination with employers, and providers already operate in a transparent manner given they have signed a Memorandum of Understanding (MOU) with the State of California. New registration requirements will standardize and regularize reporting, which I believe will improve efficiency and transparency in the delivery of EWA products. This will come at additional costs that have been outlined in the Proposal as not being excessive, though it will clearly tilt the balance in favor of larger providers and may become harder to bear for smaller providers. This may reduce competitiveness in the marketplace, which usually leads to oligopolies/monopolies that are not in the interests of consumers, especially the more vulnerable ones. It is my hope that the final version of these requirements will be designed to provide a pareto-optimal[1] tradeoff such that all parties (consumers, providers, and taxpayers) are all better off. I believe this is the intention of the Proposal.

2. **The Proposal incorrectly classifies EWA as a loan.**

The new regulation also designates EWA as follows: "... an advance of funds to be repaid from a consumer's future earned or unearned pay is a loan subject to the CFL."[2] I believe this definition is ill-framed. Employees with earned wages are effectively *owed* compensation by employers and are not borrowers. EWA only accelerates access to money already owed to employees. By designating EWA as a loan, the regulation would change the status of employees from (quasi) creditors into debtors, arguably a perverse interpretation and outcome. Indeed, in bankruptcy, it is already established that earned wages (and benefits) become priority unsecured debt, reflecting the legal position that far from being given a loan, it is employees who already own their wages.[3]

There are several features of EWA that demarcate it from being a loan. The employee does not "repay" the loan. On the date when wages are paid (usually every two weeks), employees receive the remainder of their earned wages, including wages that were not earned when they gained access to earned wages earlier. The only thing that EWA does is change the timing of wage payments, which is very different from taking a loan. Employers set aside the amount of the accessed wages in escrow for the provider and at no time is employee debt created. The employee is simply using a benefit offered by the employer to access wages early. The verbiage that "... such arrangements still involve an agreement in which the consumer receives money that they agree to repay in the future"[4] semantically attempts to paint EWA as an extension of credit, but this is logically unconvincing. **All consumers and employers have done is agree to change the timing of wage payments.**

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[1] Pareto efficient design occurs when the revised regulation makes all parties better off and no one is worse off. See: https://en.wikipedia.org/wiki/Pareto_efficiency

[2] PRO-01-21-NOPA, page 5.

[3] The Bankruptcy Code grants certain employee claims "priority" status, thereby entitling covered employees to more favorable treatment than some—but not all—of the other interested parties in the bankruptcy case. https://crsreports.congress.gov/product/pdf/LSB/LSB10288

[4] PRO 01-21 Initial Statement of Reasons, page 24, middle of last paragraph.

No interest is charged, only an optional, nominal processing fee, which is the same irrespective of the timing and amount granted under earned wage access. This is analogous to an ATM fee for covering the cost of access and convenience.

3. **The Proposal fails to make a meaningful distinction between earned and unearned income.**

Lumping earned and unearned income into the definition above also ignores the difference between the two, which is critical. Earned pay is owed to employees, whereas unearned pay is not. It is for this reason that the nomenclature Income-Based Advance (IBA) is too broad and mischaracterizes the product being offered. In contrast, Earned Wage Access (EWA) clearly specifies that the wages in question are "earned" and hence "owed to" the employees, which logically sets it far apart from being a loan. The wording "income-based advance" makes no distinction between earned and unearned wages and uses the word "advance" that makes it sound like a loan. In doing so, it seeks to cast a wider net, eschewing sharper and clearer definition of the EWA marketplace, risking imposing additional regulations that may only make the marketplace less efficient, less competitive, and more costly. I strongly recommend that the Proposal revisit this nomenclature before moving forward.

4. **Designating EWA as a loan will force consumers to turn to high-cost, predatory lending alternatives.**

Without access to earned wages, consumers must turn to high-cost traditional lending products like payday loans, title loans, and bank account overdraft. The EWA marketplace has successfully rescued thousands of consumers from the clutches of these predatory products. EWA is truly a benefit that is provided to employees at no cost to their employers, especially given that employers are not interested in providing loans to their employees. Designating EWA as a loan will disincentivize employers from adding this benefit for their employees, making them considerably worse off. Millions of employees will lose access to free or low-cost access to liquidity. This strongly contradicts the goals of consumer access and protection, and drives them away to more costly alternatives.

5. **Designating EWA as a loan will create more costs and fees for consumers.**

Onerous licensing and registration requirements will increase costs that will be passed on to consumers in higher processing fees. Designating EWA as a loan will attract lending regulations, which will impose further costs, which will also be passed on. In fact, the lending markets are replete with additional costs in terms of higher interest rates, points, processing fees, etc. As costs rise, smaller players in the EWA market will be pushed out, reducing access to this benefit, or leading to some players using lending market comparables to charge excessive fees. Costly oligopolies will also reduce competition in the EWA market, with declining access and choice for consumers.

EWA is a different product than many of the other lending products that the Proposal seeks to regulate, and it should be handled differently. The EWA marketplace has been a life-saver for vulnerable consumers and has been well-regulated so far. I applaud the Department of Financial Protection and Innovation for seeking to standardize the marketplace in a manner that supports both businesses and their employees "... by improving accountability and transparency of financial products and services and protecting consumers from abusive business practices and high-cost products."[5] I believe that EWA products are not loans and that designating them as such would make employers and employees worse off. I also believe that designating EWA as lending is not necessary to achieve the goals set out above, and may in fact, detract from those goals.

Sincerely,

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[5] PRO-01-21-NOPA, page 8.