February 6, 2024

VIA EMAIL (regulations@dfpi.ca.gov)

Department of Financial Protection and Innovation
2101 Arena Boulevard
Sacramento, California 95834

RE: EarnIn's Comments on the Second Modified Text of Proposed Rulemaking under the California Consumer Financial Protection Law and California Financing Law, et. al (PRO 01-21)

Dear Sir/Madam:

Activehours, Inc., d/b/a EarnIn ("EarnIn") is grateful for this opportunity to provide comments to the California Department of Financial Protection and Innovation ("DFPI" or "Department") in response to its invitation for comments on the proposed rulemaking under the California Consumer Financial Protection Law ("CCFPL") and California Financing Law ("CFL") among other laws (PRO 01-21). EarnIn continues to welcome purposeful regulation of Income-Based Advances ("IBAs") and appreciates the DFPI's efforts and consideration regarding the comment letters received by its office in March, April, and November 2023.

However, EarnIn remains deeply concerned that the proposed rule continues to characterize IBAs as loans, which is contrary to existing law. The Department appears to have overlooked important distinctions between IBAs and loans and there is no policy advantage to characterizing IBAs as "loans". Shoehorning IBA into the definition of "loan" undermines consumer understanding and choice, creates problematic precedent, and intellectually corrupts the legal concept of a loan.

In this letter, we reiterate our previous comments and further describe the differences between IBAs and loans, and the negative consequences to industry and consumers from characterizing IBAs as loans. We then recommend key changes to the proposed rule to address our concerns.

Section I: IBAs are Not Loans Under California Law.

Non-recourse advances[1] are not "loans" under the CFL or other California law and DFPI

[1] EarnIn's Cash Out Terms (the EarnIn's Cash Out User Agreement) provides that the consumer has no obligation to repay an advance and that EarnIn will have no legal or contractual claim or remedy against a consumer based on the failure to repay any advance. If though a consumer provides EarnIn with a revocable debit authorization for repayment, that does not establish "a legal obligation" to repay and does not establish a "debt. Indeed, in the event the consumer chooses not to repay or if the debit fails due to a lack of no funds available, or if the debit authorization fails, EarnIn warrants that it will not (i) engage in any debt collection activities against the consumer, (ii) place the amount of the outstanding advance as a debt

should ensure that its regulation reflects the same. The CCFPL defines "credit" as the right to "incur debt and defer its payment," and in order to meet the definition of debt there must be "an obligation… to pay."[2] Similarly, the usury provisions of the California Constitution contemplate that in order to exceed the maximum interest rates allowable there must be an underlying legal *obligation*.[3]

As previously communicated to the Department, EarnIn Cash Outs create *no* legal obligation to repay. A consumer may close her bank account, withdraw funds, revoke EarnIn's debit authorization, or otherwise choose not to repay for any reason. Loans are loans because they create an obligation; an obligation that can be *enforced*—in court or otherwise—by a lender. Concerns associated with enforcement, e.g., foreclosure, repossession, payment of mandatory fees, etc., drive lending law. Eliminating the possibility of enforcement eliminates the need for the same type of regulation. Non-recourse advances are simply not loans. And because non-recourse advances do not present the consumer protection concerns motivating regulation of lending, non-recourse advances should not be characterized as loans under the rulemaking.

Outside of California, other state entities have confirmed that IBAs are not loans. The Arizona Attorney General issued an opinion that an IBA "that is offered as a no-interest and non-recourse product" is not a consumer loan under state law.[4] Similarly, Kansas issued an interpretive opinion to an IBA provider, finding it to not be issuing a "debt".[5] Missouri and Nevada also passed comprehensive legislation to explicitly exempt IBAs from traditional lending laws.[6] This list has grown since our last letter, with the Montana Attorney General opining that IBAs are not loans under the relevant state laws because they lack a right to repayment.[7] This guidance rightly recognizes the meaningful distinctions between IBAs and loans and we strongly encourage DFPI to do the same. Indeed, not only do these opinion letters adopt rationale that is directly relevant and that should be adopted in this rulemaking, the rationale in these letters is also present in DFPI's own 2022 CFL opinion letter regarding a product offered by one of EarnIn's competitors.[8] Notably, the DFPI's opinion resembles that of the Attorneys General of Arizona and Montana. Each of the three opinions evaluated the relevant statuary definition of "loan"[9] by looking

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with, or sell it to, a third party, or (iii) provide any reporting to a consumer reporting agency concerning the amount of the advance.

[2] Cal. Fin. Code § 90005 – defining credit and debt.

[3] California Constitution Article XV – establishing usury caps.

[4] Arizona Attorney General, Opinion I22-005 (R22-011), available at https://www.azag.gov/opinions/i22-005-r22- 011.

[5] Kansas Office of the State Bank Commissioner, Response to Request for an Interpretative Opinion (Jul. 7, 2022), available at https://flexwage.com/wp-content/uploads/2022/12/FlexWage-Solutions-Kansas-OSBC-Opinion-Letter-070722.pdf.

[6] Missouri Senate Bill 103 (2023), available at https://senate.mo.gov/23info/BTS_Web/Bill.aspx?SessionType= R&BillID=44662, and Nevada Senate Bill 290 (2023), available at https://www.leg.state.nv.us/App/NELIS/ REL/82nd2023/Bill/10146/Overview.

[7] Montana Attorney General, 59 Mont. Op. Atty. Gen. No. 2 (Dec. 22, 2023), available at https://rules.mt.gov/gateway/ShowNoticeFile.asp?TID=12009.

[8] DFPI, *Re: Request for Interpretive Opinion – FlexWage*, OP-8206 (Feb. 11, 2022), *available at* https://dfpi.ca.gov/wpcontent/uploads/sites/337/2022/02/FINAL-OP-8206-FlexWage-Specific-Ruling.pdf

[9] DFPI's opinion also discusses whether the product at issue constitutes a sale or assignment or order for the payment of wages under the CFL. This rulemaking elides any distinctions between transaction types, declaring that covered advances are simultaneously (1) a sale of wages; (2) an assignment of wages; and

to Black's Law Dictionary and relevant case law to support similar conclusions that the product in question was not a "loan" in the absence of an obligation to repay and enforceable right to repayment.[10] This reasoning applies equally in distinguishing IBAs from loans. Advances that do not create a legally enforceable repayment obligation are not loans in Arizona, Montana or California and such distinction should be reflected in this rulemaking.

Section II: Characterizing IBAs as Loans Would Be Harmful to Consumers and Providers

Characterizing IBAs as "loans" would have multiple material, adverse consequences. First, and most importantly, this designation would create consumer confusion. As noted above, a key—perhaps *the* key—characteristic of IBA is that it is non-recourse: the provider has no legal recourse against a consumer that has not repaid an IBA. This is fundamentally different from a loan transaction. A lender's recourse—the possibility of liens, wage garnishment, negative credit reporting, third-party debt collection—inspires fear in many consumers. As a result of lenders' recourse, consumers may be wary of taking out loan obligations and particularly wary of the prospect of default.

EarnIn, however, has no recourse against consumers in the event of nonpayment. Unlike lenders, EarnIn cannot aggressively pursue collection. EarnIn cannot report an unpaid Cash Out to a credit bureau. EarnIn cannot sell a right to repayment to a debt collector because EarnIn has no right to repayment. Customer fear of lenders is not properly attributed to EarnIn: EarnIn's service presents no prospect of the adverse outcomes that have historically plagued borrowers. Indeed, in an internal survey of EarnIn's customers, over a third responded that they were less likely to use an EarnIn product structured as a loan.[11] More than half of EarnIn's customers further responded that in the absence of Cash Out and similar IBAs, they would be "disappointed." Such customers admitted that they would be likely to turn to other liquidity options for which they would incur fees, such as paying a bill late, overdrawing account, financing a bill on a credit card and paying the balance off over time, or taking out a payday loan.[12]

The confusion engendered by the misnomer "loan" could also prevent consumers from properly prioritizing payment decisions. If a consumer thinks of IBA in the same vein as a mortgage payment or a credit card payment, a cash-strapped consumer might choose to repay her IBA and default on her obligations. As noted above, because nonpayment of an IBA

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(3) a loan, (though not an "order" for the payment of wages) under the CFL. *See* Cal. Code Regs. tit. 10 § 1461(a) (proposed). Putting aside the intellectual acrobatics associated with characterizing a transaction as a sale, an assignment and a loan, the logic of this opinion letter–that employer-based advances do not create an obligation to repay an employer and therefore are not "loans"–should extend to any IBA that does not create an obligation to repay, i.e. non-recourse transactions. Similarly, because IBAs are non-recourse, they do not constitute a sale or assignment of, or order for, the payment of wages. These terms are clearly defined by common law to involve enforceable rights to wages not present in non-recourse transactions, and modified by the CFL only to include wage assignments that purported to be enforceable even if they were not, as previously communicated to DFPI, and as reflected in DFPI's analysis of the CFL's legislative history. *See* OP-8206, pages 4-5.

[10] *See id.* (citing Civil Code § 1912, *Milana v. Credit Discount Co.* (1945) 27 Cal.2d 335, 339, and Black's Law Dictionary (11th ed. 2019)).

[11] EarnIn, *How do CMs perceive EarnIn* (2024) (survey of 1,343 EarnIn customers) (on file with Earnin).

[12] *Id.*

engenders no adverse consequences to the consumer, repaying an IBA ahead of a mortgage payment could have significantly more detrimental effects on the consumer than nonpayment of IBA. The "loan" terminology undermines the consumer's ability to make informed decisions about how best to organize her payment obligations.

Second, calling IBA a "loan" would have a deleterious effect on the IBA industry in other jurisdictions. California has long been a leader in financial services regulation and a state that other states look to for guidance. If California considers IBA to be a "loan," other states may assume that IBA is a loan without further inquiry or nuance. In turn, this could lead other states or private plaintiffs to pursue IBA providers for unlicensed lending, usury, or other legal violations without regard to the fact that non-recourse IBA is markedly different from lending and, as California has recognized, should be treated differently than traditional lending. Imposition of traditional lending requirements would make it impossible for IBA providers to operate in certain jurisdictions thus depriving consumers of a valuable liquidity option and forcing those consumers to turn to payday lenders, overdraft, and/or incur credit card fees. If DFPI were to characterize IBA as a "loan", many consumers may turn to predatory and expensive liquidity options—options that are categorically worse for the consumer than IBA.

Similarly, the characterization of IBAs as loans, along with the broad definition of "charges", may inadvertently and inappropriately be used in California. In particular, the gratuitous labeling of IBAs as loans may create uncertainty regarding the application of the usury provisions of the California Constitution to IBAs, notwithstanding language to the contrary in the proposal.[13] We believe that the Legislature intended the DFPI rulemaking to increase clarity and not add ambiguity.

We also believe the Legislature sought to encourage innovative solutions not limit them. And yet, the DFPI's proposal would materially restrict IBA providers' ability to operate in the state. For example, we note that calling IBA a loan would have a harmful effect on the IBA industry's business with advertising and other platforms and may indeed eliminate access to them. As a notable example, in 2019, Google banned applications for loans that require repayment in full in 60 days from Google Play, Google's official pre-installed app store on Android-certified devices.[14] IBAs are not loans nor do they "require" repayment at any point. Yet, if DFPI calls these products loans and does not distinguish between loans and non-recourse based advances, consumers may find IBA products banned from the Google Play app store, unnecessarily forcing those consumers to less favorable and predatory alternatives.

Third, expanding the definition of "loan" to include fully non-recourse transactions is simply not in line with historical or academic conceptions of lending. What is a loan if it does not engender an obligation to repay? What consumer protection concerns associated with a non-recourse transaction are served by using the term "loan" that cannot otherwise be served through disclosure requirements? California law has long recognized nuanced distinctions between loans, sales, credit sales, and other types of transactions based on the recourse available to the parties.

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[13] California Constitution Article XV § 1 (limiting the interest or other charges that can be assessed on a "loan" or forbearance).

[14] *See* Google LLC, Financial Services – Play Console Help, available at https://support.google.com/googleplay/android-developer/answer/9876821.

Ignoring these distinctions in the IBA context is out of line with past precedent and blurs the legal definition of a loan.

Finally, we reiterate that DFPI need not characterize IBA as a "loan" in order to regulate or supervise IBA providers. Members of the EWA industry proposed a reasonable approach to licensure and supervision of providers that is consistent with the authority granted to the DFPI by the California Legislature and does not require characterization of IBA as a "loan." As noted above, use of the term "loan" materially and negatively impacts IBA providers, and does so without any clear justification or rationale by the DFPI when such a characterization is simply not required. DFPI retains the right to supervise and impose various consumer protection obligations on providers without utilizing inaccurate and divisive terminology. We strongly encourage DFPI to do so. There is no substantive advantage that DFPI gains by calling IBA a "loan."

Section III: Our Recommendations

To avoid these unintended and adverse consequences, EarnIn recommends that DFPI further amend the proposed rule to clarify that IBAs are not loans.

In particular, we recommend that DFPI strike subdivision (f) of section 1461 which states that "Income-based advances under California Code of Regulations, title 10, section 1004, subdivision (g), are loans under subdivision (a) of this section."

Similarly, DFPI should revise subdivision (a) of section 1461 which states that a non-recourse advance is "a sale or assignment of wages and a loan subject to the California Financing Law" to indicate that advances of funds described in the section are not sales or assignments of wages, nor a loan, if the advance is non-recourse. With that change, subdivision (e) can also be deleted for consistency.

Finally, EarnIn recommends that DFPI expand subdivision (d) of section 1461 to further clarify that the Department does not intend to interpret any authority other than the ones expressly cited (i.e. the CFL, CCFPL and CDDTL). While the Department has included a variety of authorities for which it expressly disclaims an issuance of interpretative guidance–which EarnIn supports–EarnIn believes that further revision is necessary to avoid inadvertent inferences that the rulemaking can or should be used to interpret other provisions of California (or other) law.

For example, this subdivision states that it "[t]his section shall not be read to interpret what is considered . . . or a loan or forbearance of money under the California Constitution, article XV, section 1." While this may be a helpful clarification, EarnIn is concerned that this type of statement might unintentionally suggest the section *may* be read to interpret DFPI's rulemaking as interpreting *other* terms in the California Constitution, such as what is considered a charge, interest, or fee, bonus, commission, discount or other compensation for purposes of California's usury law.

Accordingly, EarnIn recommends that DFPI revise the subdivision to state that the section should not be read to interpret *any* law or authority not expressly cited therein and list as examples the following: (1) a wage assignment under the Labor Code, (2) consumer credit or debt under federal law, including the under the federal Truth in Lending Act (15 U.S.C. § 1601 et seq.), or (3) a loan or forbearance of money, or interest, or fee, bonus, commission, discount

or other compensation thereon, under the California Constitution, article XV, section 1.

Our recommendations are reflected as proposed text below. Proposed additions to the Second Modified Text of the Proposed Regulations are underlined and proposed deletions are struck through. Bracketed ellipses reflect omissions in the quotation.

§ 1461. Advances Under the California Financing Law.

(a) Any advance of funds to be repaid in whole or in part by the receipt of a consumer's wages, salary, commissions, or other compensation for services is a sale or assignment of wages and a loan subject to the California Financing Law, regardless of the funding provider's means of collection, ~~whether the provider has legal recourse if the provider is unable to collect the amount it advanced~~ unless the provider makes the warranty described in California Code of Regulations, title 10, section 1004, subdivision (g), paragraph (3), and ~~whether~~ the consumer has the right to cancel collection of the amount advanced. This section does not apply to obligors as defined by California Code of Regulations, title 10, section 1004, subdivision (h), who advance from their own funds only income that has accrued to the benefit of a consumer but has not, at the time of the advance, been paid to the consumer.

[...]

(d) Except as expressly provided for, this ~~This~~ section shall not be read to interpret any other law, including but not limited to what is considered a wage assignment under the Labor Code, consumer credit or debt under federal law, including the under the federal Truth in Lending Act (15 U.S.C. § 1601 et seq.), or a loan or forbearance of money, or interest, or fee, bonus, commission, discount or other compensation thereon, under the California Constitution, article XV, section 1.

~~(e) A provider of an advance of funds as described in subdivision (a) does not require a license under the California Financing Law if:~~

~~(1) The advance of funds is an income-based advance as defined by California Code of Regulations, title 10, section 1004, subdivision (g), and~~

~~(2) The provider is registered with the Department to offer income-based advances under California Code of Regulations, title 10, section 1010. This paragraph shall expire when the registration requirements for income-based advance providers under section 1010 expire.~~

~~(f) Income-based advances under California Code of Regulations, title 10, section 1004, subdivision (g), are loans under subdivision (a) of this section.~~

Conclusion

IBA products empower customers to access wages as those wages are earned, to solve short-term liquidity crunches and take control of their finances. IBAs, however, are not loans, as other regulatory agencies have concluded. Regulating IBAs as loans would not align with accepted legal precedent and could create uncertainty for years to come.

EarnIn therefore respectfully recommends relatively modest and technical changes to

language in the proposal. Characterizing IBAs as loans would provide no discernable advantage to the Department, consumers, or industry, but *would* create a host of problems for California consumers and businesses.

Thank you for considering these comments. We look forward to continuing to work with the DFPI to develop thoughtful IBA regulations that encourage innovation, consumer access and transparency, without inadvertently harming consumers through regulatory mismatch. Please do not hesitate to contact me if you would like to discuss these comments or if EarnIn can provide any other information.

Sincerely,

David E. Durant
General Counsel
Activehours, Inc., d/b/a EarnIn