March 15, 2021

By email to regulations@dfpi.ca.gov
Commissioner Manuel P. Alvarez
Department of Financial Protection and Innovation
300 S. Spring Street, Suite 15513
Los Angeles, CA 90013

Re: PRO 02-21, Proposed Rulemaking under the California Consumer Financial Protection Law: Earned Wage Access

Dear Commissioner Alvarez,

The National Consumer Law Center, on behalf of its low income clients, and the Center for Responsible Lending thank you for the opportunity to submit comments on your proposed rulemaking under the California Consumer Financial Protection Law (CCFPL). The CCFPL gives the Department of Financial Protection and Innovation (DFPI) important new powers to protect consumers, and we are pleased to offer our views on how to use them.

Since 1969, the nonprofit National Consumer Law Center (NCLC) has worked for consumer justice and economic security for low-income and other disadvantaged people in the U.S. through its expertise in policy analysis and advocacy, publications, litigation, expert witness services, and training.

The Center for Responsible Lending (CRL) works to ensure a fair, inclusive financial marketplace that creates opportunities for all credit-worthy borrowers, regardless of their income, because too many hard-working people are deceived by dishonest and harmful practices.

This set of comments will focus on earned wage access programs and other newer types of payday advance programs. NCLC and CRL have also joined a broader set of comments submitted by the California Economic Justice Coalition on a broader range of issues and a second set in conjunction with the Student Borrower Protection Center on income share agreements.

These comments will focus in particular on these questions that DFPI poses: For what industries should DFPI first establish registration requirements under Financial Code section 90009(a)? What are the consumer protection risks posed by those industries? Should DFPI issue regulations clarifying the applicable state credit cost limitations for consumer financial products and services offered by covered persons under the CCFPL?

In brief, we believe that earned wage access products and other newer payday advance programs do pose risks to consumers that require attention. First and foremost, these products are credit and should be governed by the protections, in particular usury laws, that apply under credit laws for other forms of credit. Failing to treat these advances as credit risks opening of a broad avenue for evasions, both for payday advance products and for other forms of credit that use similar arguments to claim they are not offering credit or loans.

To say that earned wage access and other forms of payday advance or overdraft protection products are credit does not mean that they should be outlawed. But they need, and should be subject to, the consumer protections that apply to credit. With their balloon-payment structure and immediate repayment on payday, these products have striking similarities to traditional payday loans, even if sometimes at a lower cost (for now). They pose many of the same risks to consumers. This makes it all the more important that DFPI give serious consideration to how California's credit laws apply – in particular usury laws – apply to these products. The Department must not prematurely bless these products as "responsible" ones that should be encouraged.

The importance of viewing these payday advances as credit goes beyond these products themselves. The very same arguments that are being used by these industry participants to claim that they are not offering credit can be, and are being, used by other companies offering even more dangerous products. If DFPI falls into the trap of accepting their arguments, it will be creating an enormous path for evasion of California's strong credit protection laws, especially the usury laws that California recently strengthened.

Below, we will briefly discuss aspects of these products that pose risks to consumers, why they are offering credit, and why it is essential that California not permit evasions of its laws governing credit, in particular its usury laws. We will not dissect each company's business model or discuss every aspect that concerns us, nor offer a detailed legal analysis as to why these products constitute credit. But we will briefly explain our conclusion about which laws apply.

In short, we urge DFPI to require payday advance companies that debit bank accounts up to $300 to obtain licenses under the California Deferred Deposit Transaction Law (CDDTL). Though it is our position that the fees permitted under CDDTL are far too high and should be reduced, it is important not to create artificial distinctions between different forms of payday loans. We also urge the DFPI to exercise its new authorities under the CCFPL to adopt requirements, similar to the Consumer Financial Protection Bureau's 2017 payday loan rule, to prevent unaffordable cycles of debt by requiring the loans to step down in size followed by a cooling off period.

For all debits above $300, as well as all employer-based advances that do not debit bank accounts and thus are outside the CDDTL, the Consumer Financing Law applies. They should be required to obtain finance lender licenses and to comply with the CFL usury cap.

If for some reason DFPI decides not to require CDDTL or CFL licenses, these products are still loans, and California's constitutional usury cap does and should apply. While DFPI cannot itself establish a usury limit, it also cannot authorize evasions of existing usury laws. In the face of ambiguity, if DFPI decides to establish an alternative registration regime, it must prevent evasions of usury laws by ensuring that it applies only to products with *de minimis* fees of no more than $5 per month.

1. Background

DFPI has already entered into a series of memoranda of understanding (MOUs) with companies that give consumers advances on earnings before paydays: PayActiv, Branch Messenger, Activehours dba Earnin, Bridge IT dba Brigit, and Even Responsible Finance.

DFPI refers to these as "earned wage access" (EWA) companies, and characterizes the companies as representing "two advance pay models: an employer-based model which offers early access to wages in partnership with an employer as a benefit and a direct-to-consumer model which does not require employer participation."[1]

DFPI states: "The MOUs pave a path so earned wage access companies can continue operating in California, in advance of possible registration under the California Consumer Financial Protection Law …"[2] The MOUs require the companies to submit quarterly reports with several metrics and to "follow industry best practices and disclose any potential fees the earned wage access companies assess."[3] Unfortunately, these reports will not be available to the general public.

The MOUs do not reflect DFPI's "approval of Company's business model or conclusion that the model complies with state or federal law," and the MOUs do not prevent DFPI from asserting that the products require licensure or registration under any law under the Department's jurisdiction.[4]

It is reasonable for DFPI to collect information about these companies while it studies how to regulate them. We also appreciate that the Department has not "approved" the products, has not stated any conclusions about which legal regime applies to the companies, and has not ruled out

[1] DFPI, Press release, The DFPI Signs MOUs Believed to be Among the Nation's First with Earned Wage Access Companies (Jan. 27, 2021) ("DFPI EWA Press Release"), https://dfpi.ca.gov/2021/01/27/the-dfpi-signs-mous-believed-to-be-the-among-the-nations-first-with-earned-wage-access-companies/.
[2] *Id.*
[3] *Id.*
[4] *See, e.g.*, Memorandum of Understanding, PayActiv, Inc. at 5 (Jan. 14, 2021) ("PayActiv MOU"), https://dfpi.ca.gov/wp-content/uploads/sites/337/2021/01/Admin.-Action-Payactiv-Inc.-Memorandum-of-Understanding.pdf.

the possibility of regulating the companies under the California Financing Law (CFL), the California Deferred Deposit Transaction Law (CDDTL), or another credit statute.

Nonetheless, we are concerned that the tone of the Department's press release reflects a pre-ordained conclusion that these products reflect "responsible innovation," that their current practices are "best practices," and that the products are not loans covered under existing California or federal law. We urge DFPI, instead, to regulate the products as credit and to pay attention to potential consumer harms.

2. EWAs, Faux EWAs, and Other Payday Advance Apps Offer Credit

As DFPI states, the five companies broadly fall into two categories: an employer-based model and a direct-to-consumer model. Only the employer-based models have any claim to be called "earned wage access," even though, as discussed below, they are not actually accessing wages. Other models that claim to access wages have no connection to the payment of wages, and we will refer to them as "faux EWAs." A third category or product, such as Brigit, do not claim to pay wages but rather style their loans as no-interest advances or overdraft protection. Collectively, we will refer to all three categories as "payday advances," "payday advance products," or "payday advance apps."

In this section we discuss conceptually why these products are credit. In section 6 below we address the application of specific California credit laws.

Not even the EWA products are actually paying wages, earned or otherwise. As we understand their models, in most instances, the EWA company – a third party, not the employer – advances funds to the consumer and is repaid later in some fashion, such as through payroll deduction from the employee's pay, by offsetting the debt before funds are deposited to a debit card, or by debiting the consumer's bank or prepaid account.[5]

Indeed, if the EWA payments were actually wage payments, then the fee might be an unlawful deduction.[6] An early wage payment by the employer also could trigger a requirement on the employer's part to deduct taxes.

The fact that the consumer has worked and has earned unpaid wages does not mean that a payday advance is not a loan. Consumers who take out payday loans also have often worked several days since their last payday but are running short of funds before the next payday. Verification of coming earnings – whether directly through a connection to the employer's time and attendance system or indirectly by monitoring the employee's work habits – is merely a form of underwriting. Moreover, unearned wages are not a bank account that employees have a right to access; they are an obligation owed to the employee that is not owed until payday.

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[5] Some EWA companies use different models to be repaid, such as receiving the direct deposit of the wages, deducting the advance and fees, and forwarding the balance to the consumer's account. In some EWA models, the employer or its payroll provider may pay the advance.

[6] *See generally* Calif. Dept. of Industrial Relations, Deductions, https://www.dir.ca.gov/dlse/FAQ_Deductions.htm.

Similarly, the fact that a loan is repaid by payroll deduction does not mean that the payday advance was a payment of wages or that the repayment is not repayment of a loan. Many employers offer payroll deduction loans.[7]

Moreover, repayment of payday advances can fail because the worker does not in fact have sufficient, net earned wages to cover the loan. For example, a garnishment could reduce the take-home pay. PayActiv's agreement, for example, gives it the right to twice re-present a failed payroll deduction against future pay:[8]

> If any FFRWP and Program fee deduction or debit (as applicable) is not successfully deducted or debited (as applicable), or is only partially deducted or debited (as applicable), on the original Scheduled Payday, for any reason including administrative error, other priority deductions or debits (as applicable), or for any reason there are insufficient net wages to cover the FFRWP and any applicable Program fees, you authorize your Employer to attempt such deduction on each of the next two Scheduled Paydays from any wage payment made on those successive Scheduled Paydays, or as applicable you authorize PayActiv to make two further debit attempts, until the FFRWP and applicable Program fees are successfully deducted or debited.

Similarly, Earnin's agreement states: "Failed or rejected debits may be reinitiated at any time up to 150 days after the first debit."[9]

This right to repayment from future wages or income further reveals that these are loans, not payment of wages.

Faux EWAs and other payday advance apps that have no connection to payroll have an even more attenuated argument that they are not credit. Mechanisms such as location tracking and uploading of timesheets are merely methods of underwriting; they do not convert loan advances into wages. These are advances before payday – a payday loan. Like other loans, they are paid by authorizing repayment by debiting the consumer's bank or prepaid account. The fact that the providers are confident enough of their ability to recoup the payment through debiting the account to give up on other collection methods does not mean they are not offering credit.

3. Payday Advance Apps Pose Many of the Same Risks as Traditional Credit, Including Payday Loans

Employer-based EWAs, direct-to-consumer faux EWAs, and other payday advance apps all present many of the same issues and risks as other balloon-payment payday advance loans. In some instances, the fees are lower and the repayment and collection methods are less onerous. But concerns remain.

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[7] An example of a TrueConnect payroll deduction loan is a $1,000, 12-month loan at 19.99% APR. https://trueconnectloan.com/faqs/ (see asterisk footnote).

[8] Program Terms and Conditions ¶ 3.2 at 3 ("PayActiv Terms and Conditions"), Appendix A to Compliance Assistance Sandbox Submission to CFPB from Payactiv, Inc. ("PayActiv Sandbox Submission"), https://files.consumerfinance.gov/f/documents/cfpb_payactiv_approval-request_2020-12.PDF.

[9] https://www.earnin.com/privacyandterms/#terms.

First, they pose the risk of a cycle of debt when repayments are not affordable. Taking an advance on the next paycheck when a consumer cannot cover an expense with the current paycheck creates a hole in the next paycheck that leads to a cycle of debt and reborrowing. The cycle of debt of traditional payday loans is well known. While purporting to be two-week loans, more than three-quarters of payday loan fees come from people stuck in more than 10 loans a year.[10]

EWAs, faux EWAs, and other payday advance apps may put people into an even more extensive cycle of repeat reborrowing than traditional payday loans. The typical frequency of use for those who use these products runs from 12 times per year on the low end to 120 at the high end, with most at or above 24 times a year.[11] In other words, typical users of these products use them *nearly every pay period.*

Company	Typical Frequency Of Use	Typical Advances Per Year*
Daily Pay	1.5 times per week	78
Even	1.4 accesses per month	17
FinFit	Limit of 1 access per pay period	24
FlexWage	1 to 4 accesses per month depending on employer settings	12 to 48
Instant Financial	4 to 5 accesses per pay period	96 to 120
Payactiv	1 to 4 accesses per pay period	24 to 96

Source: Aite.
*NCLC calculations assuming semi-monthly pay.

With this cycle of reborrowing, consumers are often not getting liquidity to cover new expenses; the advances are merely filling the gap created by the prior advance. That is, like traditional payday loans, the advances create their own demand.[12] And the cycle of reborrowing creates the same problems:

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[10] Consumer Financial Protection Bureau, Payday Loans and Deposit Advance Products (April 24, 2013), https://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf.

[11] The "typical frequency of use" numbers were reported in Leslie Parrish, Aite, Employer-Based Loans and Early Pay: Disruption Reaching Scale at 13-14 (April 2019). The typical advances per year were calculated by NCLC assuming semi-monthly paychecks.

[12] *See* Leslie Parrish and Uriah King, Center for Responsible Lending, Phantom Demand: Short-term due date generates need for repeat payday loans, accounting for 76% of total volume (July 9, 2009), https://www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-final.pdf.

"After Earnin had taken all of their money out, and then after a couple of bills, I had no money," she said. "Luckily at the time I didn't have to go anywhere. The kids — I found a way to get some gas money to get them to school, I borrowed from my grandma, but it leaves you without any options, really. It's definitely a vicious cycle.

"Another Earnin user, Brian Walker, 38, said that he used the app three times before souring on it. Walker, an engineer, previously declared bankruptcy and doesn't use credit cards. He lives in Sioux Falls, South Dakota, where short-term lending is capped by law at 36 percent APR.

"The first time he used the app, to take out $100 four days before being paid, he tipped $5. After Earnin pulled his money out of his paycheck, he said he thought to himself: "I'm down $105 and I'm like, damn, I need that $100 again."[13]

Even if some carry lower fees than traditional payday loans, the balloon-payment nature of EWAs may make them a worse option than an affordable installment loan. It may be far more important to encourage employers to encourage savings and to offer low-cost installment loans instead of payday advances. For example, a $200 early wage access on a semi-monthly paycheck with a $5 fee results in a $205 shortfall in the next paycheck and likely induces the employee to take out another $200 advance. A $200 loan at 36% APR has a smaller, $35.09 semi-monthly payment, which is less likely to be unaffordable or to trigger reborrowing. At the end of three months, an employee who took out a wage advance and has rolled it over repeatedly has paid $30 in fees and still faces a hole in the next paycheck. The employee who took out the loan has paid $10.54 in interest and the loan is paid off, with no further payments.

Early Wage Access v. Small Dollar Loan for worker paid semi-monthly with wage access or loan payment each pay period		
	$200 early wage access @ $5/pay period	$200, 3-month loan (6 semi-monthly payments) @ 36% APR
Cash initially available:	$200.00	$200.00
Deduction from next paycheck:	$205.00	$ 35.09
Cost after 3 months:	$30.00	$ 10.54
Deduction from paycheck after 3 months:	$205.00	$ 0

Installment loans – which spread the cost over time and have a clear end date – are a better option for emergency or unusual expenses. But neither an installment loan nor a payday advance

[13] Cyrus Farivar, NBC News, Millions use Earnin to get cash before payday. Critics say the app is taking advantage of them. (July 26, 2019).

app is a good option for consumers who have chronic difficulty meeting ordinary expenses with their income.

Second, EWAs and other payday advance apps do not engage in underwriting for ability to repay, and most do not even take into account garnishments that reduce take-home pay. The only underwriting that payday advance apps do is to attempt to verify income to ensure that the pay will be there to cover the payroll deduction; they make no attempt to assess if the worker will be left with enough pay to manage expenses for the next pay period. In this way, too, payday advance apps are like other payday lenders – who only look to their own ability to collect, and not the borrower's ability to repay.

Moreover, to our knowledge, most EWAs and other payday advance apps can overestimate the take-home pay if a garnishment for child support, student loans, or consumer debts reduces the paycheck.[14] Wage garnishments are quite common. In 2017 – before the massive debt accruing due to the COVID crisis – the payroll provider ADP estimated that one in 14 workers was carrying a wage garnishment.[15] EWA repayments combined with garnishments may leave workers especially short. Garnishments may also cause the payroll deduction to fail – leading the app to continue attempting repayment from future pay. As discussed above, this right to repayment from future pay makes the claim that these are not loans especially untenable.

Garnishments may also expose consumers to legal claims by the payday advance provider, despite their assertion that their products are "nonrecourse." As discussed in Section 6.B below, the fine print of the PayActiv agreement requires the consumer to represent and warrant that, to the best of their knowledge, their wages are not subject to garnishment. Consumers are unlikely to notice or understand this fine print, or to think about existing or potential garnishments when they use a payday advance product. Disputes may arise about whether the consumer breached this warranty.

Third, payday advance apps have a bewildering array of pricing models that may be designed to evade usury laws, can make the costs difficult to compare to other credit options, and can make it difficult to understand how small fees can add up. Some companies charge per advance, some per pay period, some per month. Some vary depending on how quickly the consumer wants the advance. Many (but not all) EWAs are considerably less expensive than traditional payday loans – at least for now. But most do have fees that can add up. Even at the low end with fees in the range of $10 per month, are low-paid workers for whom every dollar counts truly getting help meeting expenses and managing their finances, or are they just paying to be paid? And with some models, fees or purportedly voluntary "tips" can mount considerably.

Some advances imply that they are free, yet the cost of credit is covered through a fee that supposedly covers a bundle of other services. Brigit, for example, says "Get up to $250*

[14] We understand from FlexWage that their model generally takes into account garnishments. We are not aware of any others that do so.
[15] ADP Research Institute, The U.S. Wage Garnishment Landscape: Through the Lens of the Employer (2017), https://www.adp.com/tools-and-resources/adp-research-institute/research-and-trends/-/media/RI/pdf/WageGarnishment_WhitePaper.ashx.

instantly… No interest. Pay it back without hidden fees or 'tips.'"[16] Yet advances are not available on the free plan, only with the $9.99 "Plus Plan," where the primary additional benefit is the credit.

The use of purportedly voluntary "tips" is particularly deceptive and evasive. This is not a model that DFPI should in any way condone or enable. There are several problems with the "tips" model. While the tips are purportedly voluntary, companies can employ strategies to make it difficult not to tip or to make the consumer feel compelled to tip.[17] These range from adding a default tip that must be removed each time, to different user interfaces sending psychological signals, to disingenuous statements about how the tips support a "community" rather than a large company or wealthy hedge fund, to the outright denial or reduction of future credit if the consumer does not tip enough.[18] When caught, companies may change their policies, but these for-profit enterprises with investors who need a significant return on investment will not put up with a lot of free-riding users. DFPI cannot be expected to constantly monitor the subtle and not so subtle back-end ways that companies will make sure that the vast majority of their borrowers tip. Moreover, even without any manipulations, many consumers are likely to feel compelled to tip because they believe that they will be treated differently or might be cut off if they do not.

The tipping model takes advantage of consumers' lack of awareness of how the tips add up, and how the price easily gets into the territory of payday loan pricing. The supposedly voluntary nature of the tips makes it easier to get sucked into a cycle of debt. As one borrower described:

> Earnin didn't charge Raines a fee, but asked that he "tip" a few dollars on each loan, with no penalty if he chose not to. It seemed simple. But nine months later, what was originally a stopgap measure has become a crutch.
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> "You borrow $100, tip $9, and repeat," Raines, a highway-maintenance worker in Missouri, told me. "Well, then you do that for a bit and they raise the limit, which you probably borrow, and now you are in a cycle of get paid and borrow, get paid and borrow." Raines said he now borrows about $400 each pay cycle.[19]

[16] https://www.hellobrigit.com/.
[17] *See, e.g.*, Fast Company, These 2 Black founders aim to offer a fairer alternative to payday loans (Feb. 18, 2021) ("When requesting a loan, for instance, SoLo asks borrowers to choose a "donation" to the app on top of their tip to the lender, starting at 7% or $3.50 for new borrowers seeking $50 loans. Technically, the donation is optional, but the only way to avoid it is through a toggle in SoLo's settings menu, which must be reactivated for each request. There's no way to opt out of donations while making the request itself. Industry watchdogs have also raised concerns about the tipping model. While SoLo's tips are also voluntary, and about 7% of loans funded on the platform involve no tipping at all, the app notes that loans are much more likely to be funded when users tip the maximum amount. Between tips and donations, users may end up paying a rate that's not much more favorable than payday loans, even if the model for late payments is less predatory.").
[18] Kevin Dugan, New York Post, Cash-advance app Earnin gets subpoenaed by NY regulator: source (Mar. 28, 2019) ("Earnin encouraged users to leave a tip of anywhere between zero and $14 on a $100 weekly loan. Users who don't leave a tip appear to have their credit restricted. Meanwhile, a $14 tip would equate to a 730-percent APR — nearly 30 times higher than New York's 25 percent cap.").
[19] Sidney Fussell, The Atlantic, The New Payday Lender Looks a Lot Like the Old Payday Lender (Dec. 18, 2019).

Payday loans also look cheap at $15 per $100. Payday lenders work to hide or dismiss the APR, arguing that it is irrelevant because the loans are only two weeks, not a full year, even though they know the cycle of loans lasts far longer.

Most concerning, if tips are not viewed as interest, they enable usurious lending and evasions of usury laws. The cost to the consumer is the same whether the price is labeled as a tip or as interest. Most borrowers likely have no idea what a high rate of interest they are paying:

> One former Earnin user, Nisha Breale, 21, who lives in Statesboro, Georgia — another state where payday lending is illegal — said she hadn't fully realized that, when converted to an annual percentage interest rate, what seemed like a small $5 tip on a $100 advance payment (repayable 14 days later) was actually equivalent to a 130 percent APR.
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> "I definitely didn't think about the payback time and the interest," Breale, a student at Georgia Southern University, said. "They just portray it as being so simple and so easy."[20]

Even if borrowers are fully aware of how tips or other fees translate into APRs, there is "no exception in the usury law for sophisticated borrowers."[21]

Some employer-based models can also be very expensive. The typical frequency of use for DailyPay, for example, is reported to be 1.5 times per week – 78 times per year.[22] Even at the low end of $1.99 per advance available the next business day, that is $155.22 per year. Undoubtedly many workers who use this service take the option of getting their pay immediately, at a cost of $2.99 each, or $233.22 per year if done 1.5 times per week. And those are only averages – some workers may pay far more.

Daily pay, daily fee models can also use psychological methods to encourage frequent use and frequent fees. A given day's wages may be available for early pay only if claimed that day, with messages urging the worker to draw on the wage before early pay expires. The inability to get early pay of several days' pay all at once forces a series of daily fees.

Fourth, some payday advance apps – and even some employer-based EWAs – pose a risk of overdraft and nonsufficient funds (NSF) fees. Direct-to-consumer models repay themselves by debiting the consumer's bank account. Because the apps are not truly paying wages and are only estimating when wages will be paid, they can make mistakes and trigger a repayment when income has not been deposited to cover it. For example, if the EWA provider fails to take into account an employer's one-day delay in depositing a worker's pay when the regular payday falls on a Sunday or holiday, the debit may bounce. Even employer-based models occasionally use bank account debiting in some states where regulatory issues make payroll deduction difficult or when the employee seeks an advance after the pay cycle has closed for a payroll deduction.

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[20] Cyrus Farivar, NBC News, Millions use Earnin to get cash before payday. Critics say the app is taking advantage of them. (July 26, 2019).
[21] Ghirardo v. Antonioli, 35 Cal. Rptr. 2d 418 (S.Ct. 1994).
[22] Leslie Parrish, Aite, Employer-Based Loans and Early Pay: Disruption Reaching Scale at 13 (April 2019).

As noted above, direct-to-consumer apps also retain the right to continue to debit the account after a failed payment – further revealing the fact that this is credit that is expected to be repaid.

While apps may promise to reimburse consumers for overdraft or NSF fees, that promise may not always be honored or may be difficult to enforce. Repayment may not be automatic, and consumers have reported frustration in reaching customer service and in getting fees repaid. Earnin, for example, recently agreed to settle a class action by paying up to $12.5 million:

> According to settlement documents, Earnin caused more than a quarter of a million workers to incur the overdraft and other fees that it promised it would protect them from. One of the lead plaintiffs, Mary Perks, said that she had requested $100 and $50 from Earnin, and that when the company tried to collect what it was owed, her low bank balance triggered $70 in overdraft charges, according to the suit. With $14 in tips included, Ms. Perks ultimately spent $84 on a $150 advance, according to the complaint. Earnin declined to comment on the settlement.[23]

Even after settlement of this lawsuit, Earnin is still sometimes refusing to reimburse overdraft fees triggered by its debits, as shown in this recent Better Business Bureau complaint:

> 02/09/2021
>
> I want to be refunded the over draft fees that I incurred because of Earnin. On January 8th Earnin deducted my account when my actual pay date was on a Sunday. I already told them that if my pay date falls on a Sunday, to deduct my account the following Monday. They charged my account on Friday, January 8, 2021 for over $530 I have on file to pay the day after if my pay date falls on a Sunday. They did not do that. I got hit with $180 in overdraft fees. I contacted to them only for everyone to tell me that it is my responsibility to let them know if I get paid on a different date. I did NOT get paid on a different date, I got paid on the 11th due to banks not being open on Sundays. They still refuse to reimburse me for the the overdraft fees and even made the ludicrous suggestion that I ask my bank to reimburse the overdraft fees. I haven't had any problems with earnin before January 8, 2021. They know my pay schedule, I've been with them for 3 years. They have never deducted my account on a Friday if I got paid on a Sunday. I've NEVER told them that I get paid the Friday before if my paydate falls on Sunday. All I want is for them to reimburse the $180 that would have NEVER occurred because of them. They were literally no help and I really need that $180 now to pay my light bill.
>
> **…**
>
> **Earnin Response**
>
> 02/15/2021
>
> We're sorry to hear that the community member had incurred overdraft fees due to our debits. We reviewed the community member's chat conversation and account. We debited the community member's account last 01/08 following the payroll setup of 'pays on the

[23] Tara Siegel Bernard, New York Times, Apps Will Get You Paid Early, for a Price (Oct. 2, 2020).

> 10th and 25th, holidays and weekends pay before' since most employers will pay out the business day before in the case of a bank holiday or a weekend. If this is not the case, the community member should have reached out 2-3 days prior, so we could've offered to reschedule our debits and prevented the overdraft fees. **Per our terms and conditions, we're unable to reimburse those charges in this case.** We appreciate your understanding regarding this matter. If you have other concerns or inquiries, we're live 24/7 so you can always chat with us when you get a chance.[24]

The fact that people incur overdraft fees emphasizes the lack of connection to wages and the fact that these are loans that are being repaid.

4. Payday Advance Apps Pose Risks Because More Frequent Pay May Deter Savings and Make It Harder for Consumers to Manage Expenses.

Beyond the specific issues raised in the previous section, DFPI should critically question the assumption that "innovation" in access to earned wages should be encouraged because the biweekly paycheck is "old-fashioned," and people will benefit from more immediate and frequent access to their pay. To the contrary, more frequent pay – especially for the low-wage workers who frequently use payday advances – may only make savings and financial management more difficult.

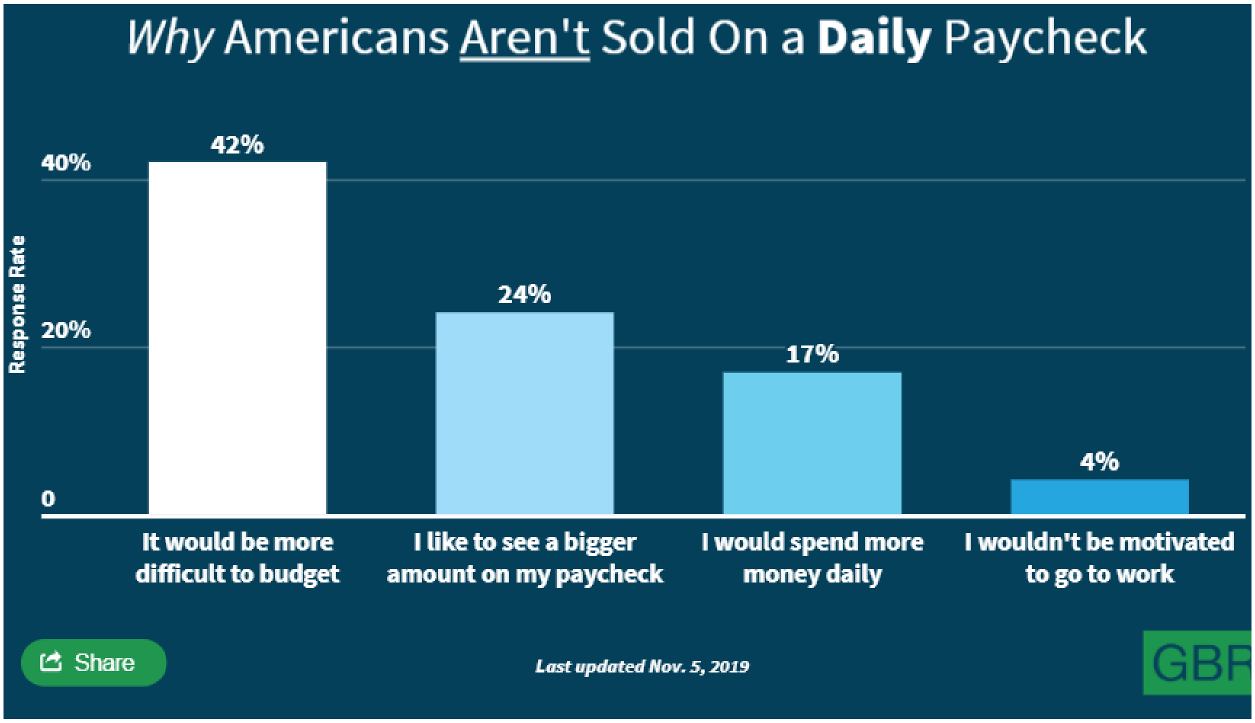
One survey concluded that "a daily paycheck could be the worst possible thing for your finances":

> "Workers that receive their wages daily tend to spend it immediately upon receipt and live on a day-to-day basis," said Salvador Gonzalez, a certified public accountant and certified internal auditor who teaches courses for the Bachelor of Science degree in accounting at Walden University. "Unlike workers who get paid weekly, biweekly or even monthly, people that earn a daily paycheck are less likely to have bank accounts, save or build assets."[25]

A survey of workers confirmed that many would find it more difficult to manage with a daily paycheck:

[24] https://www.bbb.org/us/ca/palo-alto/profile/financial-services/earnin-1216-642613/complaints. A second complaint on January 26, 2021 revealed a similar problem and a similar refusal by Earnin to reimburse the overdraft fee. *Id.*

[25] Grace Lin, GoBankingRates.com, Survey: Turns Out a Daily Paycheck Could Be the Worst Possible Thing for Your Finances: It's harder to control spending when you get paid every day (Nov. 7, 2019), https://www.gobankingrates.com/money/jobs/daily-paycheck-could-be-worst-thing-for-your-finances/.



Source: GoBankingRates.com.

"Only 8% of the survey's respondents said that getting paid daily would help them budget their paychecks better and grow their savings faster."[26]

While most payday advance apps do not result in pay every single day, they pose the risk of similar problems. Especially for workers living on low wages who are always struggling with how to pay expenses, making advance spending easy may make it more difficult to budget. Faced with an immediate need or difficult situation, it is hard to focus on consequences down the line and the resulting cycle of debt. Poverty also causes stresses that make decision-making more difficult.[27] Policymakers should not compound these problems by encouraging products that make financial management more difficult for low-wage consumers.

The traditional, full biweekly paycheck works well as a savings device for the large, once-a-month bills like rent, credit cards and utilities:

> Americans weren't wrong when they said it's harder to manage your money on a daily pay schedule — in fact, the experts agree.
>
> "As a general rule, it's easier to create a budget when your payment arrives biweekly or monthly because most major expenses (mortgage, rent, student loans, car loans, utilities) are typically paid monthly," Corprew said. "If you are receiving one or two paychecks every month, it can be easier to determine how much you need to hold for those significant bills. With a daily paycheck, you have to calculate a smaller amount, which

[26] *Id.*
[27] *See* Anandi Mani, Sendhil Mullainathan, Eldar Shafir, Jiaying Zhao, Science, Poverty Impedes Cognitive Function (Aug. 30, 2013), https://science.sciencemag.org/content/341/6149/976.

> can make it difficult to save unless you remain conscious of the exact amount needed from each day's pay."[28]

We are aware that some payday advance providers make claims about how their services reduce overdraft fees. They have not explained their methodology for coming to this conclusion. They may be making assumptions that consumers would have incurred overdraft fees in certain situations when that might not necessarily have been the case. In the absence of payday advances, consumers might have forgone spending or covered expenses in another way. Even if a given advance avoided an overdraft fee, it might have triggered a cycle of debt or encouraged excess spending that caused future overdraft fees. Industry does not make their data available for alternative analyses, so any claims should be viewed with a high level of suspicion.

EWA providers seeking to sign up employers claim that offering immediate pay makes it easier to encourage workers to offer to cover shifts. But if there is a benefit to employers, then they should pay for the services or build it into their payroll management.

DFPI does not need to resolve this policy debate. Employers are free to structure their pay schedules as they wish as long as they are not making workers pay to get paid. But as the Department considers how to treat and whether to encourage early wage access – especially those that impose costs on workers – it should keep in mind that the industry's hype about the benefits of its products is not undisputed. And the growing availability of free options to get instant pay makes it all the more important not to distort credit laws to encourage fee-based models.

5. Misconceptions about Treatment of EWAs, Faux EWAs, and Other Payday Advance Apps Under Federal Credit Laws

These comments will not go into the question whether EWAs, Faux EWAs, and other payday advance apps offer credit under federal law. But we would like to make a few quick notes before we turn to California law.

First, we strongly disagree with the assessments in an advisory opinion and compliance sandbox "approval" that the Consumer Financial Protection Bureau issued under Director Kathy Kraninger – with no public input or opportunity for contrasting views – that certain free or relatively low cost earned wage access products do not offer "credit" within the meaning of the Truth in Lending Act (TILA). Payday advances may not be covered by TILA if they are truly free and the provider is not a "creditor" since it does not regularly offer credit with a finance charge or more than four installments. But there is still a "debt" that is deferred under TILA's definition of credit, and if there is any finance charge, TILA does and should apply. We are preparing an analysis and will be urging the CFPB's new leadership to revisit the EWA advisory opinion and approval.

Second, the dangers under federal law of viewing payday advances as not offering credit go beyond TILA. The Equal Credit Opportunity Act has a similar, though somewhat broader, definition of credit. Depending on the circumstances, the same arguments used to claim that a

[28] *Id.*

product is not credit under TILA might also be used to take it out of coverage of fair lending laws.

Third, DFPI states in the MOUs that "voluntary gratuities" are not finance charges for purpose of TILA and thus are not included in the APR.[29] But that assessment may not be universally true – both because the tips may not be truly voluntary, and because in some circumstances even voluntary charges are finance charges. As the Federal Reserve Board stated when it had primary authority over TILA:

> The Board has generally taken a case-by-case approach in determining whether particular fees are "finance charges," and does not interpret Regulation Z to automatically exclude all "voluntary" charges from the finance charge.[30]

DFPI of course is not charged with interpreting TILA, though it can enforce it. But to the extent that DFPI's view of federal law influences its treatment of payday advances under California law, it is important to have and to communicate accurate information.

6. EWAs, Faux EWAs, and Other Payday Advances Are, and Should be Viewed as, Credit Under California Law

In Section 2 above, we discuss on a conceptual level why payday advances are and should be viewed as credit. In this section, we briefly discuss which of California's credit laws likely applies.

Analysis of these statutes is important because the new California Consumer Financial Protection Law (CCFPL) does not give DFPI the authority to override preexisting statutes merely because it believes it would be good policy to do so. Before creating a new registration scheme under the CCFPL, DFPI should first assess what other laws and license requirements apply.

We will not attempt here to provide a comprehensive analysis of which statutes apply to payday advances. Nor will we try to rebut every argument that some providers make about why they are supposedly not offering credit. We merely are sketching out issues that DFPI should be considering.

We do not object to interim agreements or registration while DFPI collects data and fully assesses the appropriate regulatory regime. **But it is critical that the CCFPL not be used as the easy way out to avoid confronting evasive business models that skirt important consumer protections like usury laws.**

A. Deferred Deposit Transactions (Payday Loans)

Payday advances are most similar to traditional payday loans. Both are short-term advances repaid with a single balloon payment on payday. California regulates payday loans through the California Deferred Deposit Transaction Law (CDDTL). CDDTL covers "deferred deposit

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[29] *See, e.g.*, Memorandum of Understanding, Activehours, Inc. d/b/a Earnin at 2, https://dfpi.ca.gov/wp-content/uploads/sites/337/2021/01/Admin.-Action-Activehours-Inc.-Memorandum-of-Understanding.pdf.
[30] 61 Fed. Reg. 49,237, 49,239 (Sept. 19, 1996).

transactions," defined as "a transaction whereby a person defers depositing a customer's personal check until a specific date, pursuant to a written agreement for a fee or other charge."[31] CDDTL permits checks up to a total of $300, including fees that cannot exceed $15 per $100 borrowed.

Direct-to-consumer payday advances, as well as employer-based ones that use bank account debiting,[32] are covered by CDDTL when they make debits that do not exceed $300. DFPI appears to have taken the position that electronic fund transfers such as ACH transactions are the electronic equivalent of a personal check.[33] If traditional payday lenders that use ACH debits are required to obtain a CDDTL license and to comply with the CDDTL, then fintech payday advances apps should do the same for debits up to $300.

The fees permitted under the CDDTL are excessive, and the CCDTL does not protect consumers from exploitation and a dangerous cycle of debt. But creating artificial distinctions between two categories of payday loans is not the answer. Instead, the legislature must extend strong usury limits to all payday loans, whether traditional ones or those in fintech garb. In addition, because CDDTL licensees are not exempt from DFPI's new authorities, we urge DFPI to impose additional protections, discussed below.

On the other hand, employer-based EWAs that do not debit a consumer's account do not fall under the CDDTL because they do not involve depositing a customer's personal check or the electronic debit equivalent. This category includes EWAs that are repaid through payroll deduction, as well as those that repay themselves as the direct deposit goes through either a pass-through account or a prepaid account offered by the EWA provider. Thus, as discussed below, CFL applies.

B. California Financing Law

If neither CDDTL nor some other statutory scheme such as one regulating retail installment sales or mortgage loans applies, credit then generally falls under the California Financing Law (CFL). While CFL is generally viewed as a statute that governs installment loans, that is only because balloon-payment lenders typically limit themselves to $300 debits and operate under the CDDTL. Nothing in CFL requires that the loan be an installment loan.

CFL governs "finance lenders":

> "Finance lender" means any person who is engaged in the business of making consumer loans or making commercial loans. The business of making consumer loans or commercial loans may include lending money and taking, in the name of the lender, or in any other name, in whole or in part, as security for a loan, any contract or obligation involving the forfeiture of rights in or to personal property, the use and possession of which property is retained by other than the mortgagee or lender, or any lien on,

[31] Cal. Financial Code § 23001(a).
[32] As we understand it, employer-based EWAs may still debit bank accounts in one of two situations: when an employee takes an advance at the close of payroll (when payroll is locked to further deductions) but before payday, and in states where regulatory issues limit the ability to use payroll deduction.
[34] Cal. Financial Code § 22009.

> assignment of, or power of attorney relative to wages, salary, earnings, income, or commission.[34]

"Loan" is not defined in CFL.[35] But, as discussed below, the Civil Code defines "loan of money" to be "a contract by which one delivers a sum of money to another, and the latter agrees to return at a future time a sum equivalent to that which he borrowed." With EWAs, consumers agree to return the payday advance by authorizing payroll deduction, a bank account debit, or some other mechanism, and also by agreeing to subsequent deductions or debits if the money is not fully returned by the initial attempt.

Thus, payday advance providers that debit bank accounts are making consumer loans under the CFL when their debits exceed the $300 permitted by the CDDTL.

Two provisions of CFL also confirm that EWAs repaid by payroll deduction or another payroll-linked mechanism are loans and the providers are finance lenders.

The CFL definition of finance lender includes those who lend money and take a contract involving the forfeiture of rights in, a lien on, or an assignment of wages, salary, earnings, income, or commission. That is exactly what EWAs do when they operate by payroll deduction or use another method to directly take part of a consumer's income. The EWA provider lends money and the consumer forfeits rights in their wages.

Another provision of the California Financing Law makes clear that a sale or assignment of wages in exchange for any payment is a loan:

> The payment by any person in money, credit, goods, or things in action as consideration for any sale or assignment of, or order for, the payment of wages, salary, commissions, or other compensation for services, **<u>whether earned or to be earned</u>**, is, for the purposes of regulation under this division, a loan secured by the assignment. The amount by which the assigned compensation exceeds the amount of the consideration actually paid is interest and charges upon or for the loan, calculated from the date of payment to the date the compensation is payable.[36]

EWA companies may deny that their payroll deduction agreements involve the sale or assignment of the payment of wages. PayActiv's agreement, for example, states:

> 3.6. Sale of FFRWPs ["factored future received wage payment"] to PayActiv
>
> You acknowledge that, upon the funding of any FFRWP, you have sold, transferred, and conveyed to PayActiv all of your right, title and interest in, to and under the amounts that

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[34] Cal. Financial Code § 22009.

[35] Two provisions of CFL define "consumer loan," but neither defines "loan". *See* Calif. Financing Law § 22203 (""Consumer loan" means a loan, whether secured by either real or personal property, or both, or unsecured, the proceeds of which are intended by the borrower for use primarily for personal, family, or household purposes…"); *id.* § 22204 ("(a) In addition to the definition of consumer loan in Section 22203, a 'consumer loan' also means a loan of a principal amount of less than five thousand dollars ($5,000), the proceeds of which are intended by the borrower for use primarily for other than personal, family, or household purposes.").

[36] Calif. Financing Law § 22335 (emphasis added).

> you receive with respect to the future received wage payment related to the FFRWP on a nonrecourse basis. An FFRWP is not a credit transaction and there is no interest charged. Except for assignments of wages conducted in compliance with Indiana Code sections 22-2-6-1 and 22-2-6-2, YOU ACKNOWLEDGE AND AGREE THAT YOU HAVE NOT ASSIGNED, TRANSFERRED OR CONVEYED YOUR WAGES FROM EMPLOYER OR ANY PART THEREOF. PAYACTIV HAS NO RIGHT TO ASSERT A CLAIM AGAINST YOU OR EMPLOYER WITH RESPECT TO YOUR WAGES AND HAS NO RIGHT, TITLE OR INTEREST IN, TO OR UNDER YOUR WAGES.[37]

But simply denying that a sale, transfer, and conveyance is not an assignment does not make it so.[38] Using the gobbledygook phrase "the amounts that you receive with respect to the future received wage payment related to the FFRWP" instead of the term "wages" does not mean it is not the wages being sold and assigned. Saying that "you have … transferred, and conveyed" your wages but "you acknowledge and agree that you have not … transferred or conveyed your wages" is nonsense.

And simply adding that the sale and assignment is "on a nonrecourse basis" does not make it any less of a sale and assignment of wages.[39] CFL does not require an assignment of wages to be enforceable by recourse in order for it to be considered a loan.

EWA providers point to cases unrelated to CFL involving commercial transactions and sales of receivables between businesses to argue that nonrecourse transactions are not loans.[40] But those business-to-business cases are not controlling for the consumer loans at issue here, especially given the disparity in sophistication and legal understanding between EWA providers and consumers. More importantly, the text of CFL is clear that wage assignments are loans. More

[37] Program Terms and Conditions at 5, Appendix A to Compliance Assistance Sandbox Application – Payactiv, Inc... https://files.consumerfinance.gov/f/documents/cfpb_payactiv_approval-request_2020-12.PDF.

[38] *See, e.g.*, Underwood v. Future Income Payments, L.L.C., 2018 WL 4964333, at *2 (C.D. Cal. Apr. 26, 2018) (refusing to dismiss claim that defendants violated UDAP statute by misrepresenting loan as sale of military pension payments); Bistro Executive, Inc. v. Rewards Network, Inc., 2006 WL 6849825 (C.D. Cal. July 19, 2006) (the labels that parties place on transactions are not dispositive of their true character; "cash advances" made to restaurants were disguised usurious loans).

[39] Black's Law Dictionary defines "assignment" as "The transfer of rights or property." Black's Law Dictionary (11th ed. 2019). Nothing in the definition of assignment requires that the assignee also have recourse against the assignor for additional claims should the assigned rights or property prove to be of little worth.

[40] Recourse or lack of recourse may be a factor in an assessment of the totality of the circumstances in assessing whether the parties attempted to evade usury laws, but it is not a hard dividing line between transactions that are or are not loans. For example, the case *Refinance Corp. v. Northern Lumber Sales, Inc.*, 329 P.2d 109 (Cal. App. 1958) has been cited in support of the claim that a sale transaction without recourse is not a loan. But that obscure, 60-year old commercial case has little to do with the consumer loans at issue here and nothing to do with the specific statutes governing California consumer loans. *Refinance Corp*. involved the sale by a lumber company of receivables owed by debtors that could become insolvent and might not pay the receivables. The court's primary finding was that the sales were a *bona fide* sale, and in fact the court found that separate receivable sales made *with* recourse were also sales, not loans. But wages advanced to a consumer and repaid by payroll deduction from the consumer's wages or by debiting the consumer's bank account are nothing like a commercial company buying an asset of uncertain value at less than face value.

generally, lack of recourse does not mean a transaction cannot be a loan. There are many examples of nonrecourse loans where the only remedy is to seize the pledged collateral.[41]

Moreover, payday advance companies do in fact have recourse against the consumer if the "sale" of the earned wages fails. PayActiv, for example, has the right to attempt two more payroll deductions against the consumer's future, unearned wages.[42] That is a way of collecting on an obligation. PayActiv also requires employees to make certain "representations and warranties" and "reserve[s] the right to pursue claims against individuals" that breach those representations and warranties.[43] The fine print of the PayActiv agreement states:

> You represent and warrant that, to the best of your knowledge, you have earned the net accessible wages to which the FFRWP relates, that those wages are not subject to reduction in whole or in part by reason of a valid lien or garnishment, and that by requesting an FFRWP, you have a reasonable expectation of receiving those net wages in your next scheduled wage payment.[44]

Thus, if a payroll deduction fails, in addition to the right to attempt twice more to collect the loan from future, yet unearned, wage payments, PayActiv also has the ability to assert a claim against the consumer for breaching this representation and warranty. PayActiv needs to insert this representation and warranty because it is not paying wages; it is making loans in advance of payday that it expects to be repaid on payday.

Direct-to-consumer or other payday advances that rely on debiting bank accounts are also within CFL's provisions if they are not covered by the CDDTL. There is no basis to view them as anything other than loans. Here again, the warranties and right to attempt additional debits provide a right to recourse,[45] and lack of recourse is irrelevant to CFL's scope.

Consumer loans subject to the CFL must comply with CFL's usury provisions. For small loans of the size typical of payday advances, CFL caps the rate at 2.5% per month (30% APR) for

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[41] *See, e.g., Aozora Bank, Ltd. v. 1333 North California Boulevard,* 15 Cal.Rptr.3d 340, 342 (Ct. App. 2004) ("In a nonrecourse loan like the one here, the borrower has no personal liability and the lender's sole recourse is against the security for the obligation. (1 Cal. Real Estate Finance Practice: Strategies and Forms (Cont.Ed.Bar 2003) ….").
[42] "In some circumstances, you authorize your Employer to attempt such deduction on each of the next two Scheduled Paydays from any wage payment made on those successive Scheduled Paydays, or as applicable you authorize PayActiv to make two further debit attempts, until the FFRWP and applicable Program fees are successfully deducted or debited." PayActiv Terms & Conditions at 3.
[43] PayActiv Sandbox Submission at 9 & n.11; PayActiv Terms & Conditions at 4.
[44] PayActiv Terms & Conditions at 4.
[45] The Earnin agreement, for example, not only says "Failed or rejected debits may be reinitiated at any time up to 150 days after the first debit," but also states: "you warrant that the earned wages being cashed out are just and due to you and that you have not received payment for such wages or any part of the wages from anyone else…. You agree that you will not … request a Cash Out, Max Boost, or use Balance Shield Cash Out for any earned wages that you do not have the complete right, title and interest in or for which you have already received payment;…
If we, in our sole discretion, have reason to believe that you may have engaged in any activities restricted by these Terms of Service or by law, we may take various actions to protect ourselves," including "we may take legal action against you." Earnin claims that it "will not engage in collection efforts to collect payments due to us," but it says "we may hold you liable to Earnin for the amount of damages caused by your violation of these Terms of Service." https://www.earnin.com/privacyandterms/#terms.

loans up to $225 and 2% per month (24% APR) for amounts over $225 up to $900. A $200 advance taken out seven days before payday, for example, would be allowed to charge $1.17.

Purportedly voluntary "tips" are subject to these usury rates. As discussed above, we question how voluntary the tips are. But even if the consumer voluntarily agrees to pay a usurious rate, there can still be usury. The CFL allows a licensee to "contract for and receive charges" at the above rates. Just because providers may label the payments "tips" does not mean that they are not "charges." They are added to the repayment amount before the transaction is fully consummated, and their recovery is covered in the contractual authorization to debit the account, so they are "contract[ed] for." In addition, the "tips" are received. Consumers do not tip *after* the advance has been repaid in appreciation for good service, when making an additional payment might be more purely gratuitous.

Under California law, the claim that a payment is "voluntary" does not exempt it from usury limits. As Chief Justice Roger Traynor explained:

> The theory of (the Usury) law is that society benefits by the prohibition of loans at excessive interest rates, even though both parties are willing to negotiate them. Accordingly, 'voluntary' payments of interest do not waive the rights of the payors. 'Payments of usury are not considered voluntary, but are deemed to be made under restraint.' (Citation.) If no loophole is provided for lenders, and all borrowers save fraudulent ones are protected, usurious transactions will be discouraged.[46]

Given the variety of ways that companies can induce consumers to "tip" and the understandable fear that consumers have that they will be treated differently if they do not tip enough, Justice Traynor's observation that so-called voluntary payments should be "deemed to be made under restraint" was quite prescient.

Claiming that tips cannot be usurious because they are supposedly voluntary is essentially an attempt to invoke estoppel against the consumer for initiating the usurious transaction. Courts have widely ruled that no estoppel against usury can exist when the lender knew or should have known what the usury law was.[47]

Labeling the interest as a "tip" also does not take it out of usury law. Courts look to substance, not form, and ignore the labels that the parties assign.[48]

C. Constitutional Usury Limit

Even if payday advances somehow do not fall under the CDDTL or CFL, they are still loans[49] and are then covered by the state constitutional usury limit. The California Constitution imposes

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[46] Stock v. Meek, 35 Cal.2d 809, 817, 221 P.2d 15, 20 (1950) (citing cases); *accord* Hardwick v. Wilcox, 11 Cal.App.5th 975, 988-89 (2017); Buck v. Dahlgren, 100 Cal.Rptr. 462 (Ct. App. 1972); Heald v. Friis-Hansen, 52 Cal.2d 834, 837, 345 P.2d 457, 459 (1959) ("In the absence of fraud by the borrower, the parties to a usurious transaction are not in pari delicto, and, where a loan agreement calls for usurious interest, the borrower may recover any interest paid.").

[47] *See generally* National Consumer Law Center, Consumer Credit Regulation § 7.7.2.2 (3d. ed. 2020), updated at library.nclc.org.

[48] Bistro Executive, Inc. v. Rewards Network, Inc., 2006 WL 6849825 (C.D. Cal. July 19, 2006).

a 10% usury limit on "the loan or forbearance of any money … for personal, family, or household purposes,[50] with the same limit for loans for other purposes unless a floating rate is higher.[51]

"Loan of money" is defined in the Civil Code as "a contract by which one delivers a sum of money to another, and the latter agrees to return at a future time a sum equivalent to that which he borrowed."[52] Payday advances solidly fall under this definition of "loan of money": they deliver a sum of money to a consumer, and the consumer agrees to return at a future time an equivalent sum (plus any fees or tips). That agreement to return is in the form of an authorization for a payroll deduction, a bank account debit, or another repayment mechanism, typically reinforced by an agreement to subsequent payroll deductions or debits if the first fails.

Notably, both in construing general and specific usury statutes, courts interpret usury statutes broadly and will look beyond the purported form of the transaction to prevent evasions.[53] "The courts have been alert to pierce the veil of any plan designed to evade the usury law and in doing so courts disregard the form and consider the substance."[54]

There are many exceptions to the usury limit in the Constitution, including a catch all for "any other class of persons authorized by statute."[55] The higher interest permitted by CDDTL and CFL fall into that category. But if CDDTL and CFL do not apply to payday advance products, there are no other constitutional or statutory exemptions from the constitutional usury cap. Only the legislature, "by statute," can authorize additional exemptions, not DFPI by regulation.

D. California Consumer Financial Protection Law

The CCFPL does not apply to any person acting under the authority of certain licenses, including a finance lender license under the CFL. As discussed above, we believe that DFPI should require CFL licensing for EWAs and certain other payday advance products. If DFPI goes down the route of CCFPL registration, it should only be an interim step to CFL licensing.

CDDTL licensees are within DFPI's CCFPL authority, so DFPI can and should both require CDDTL licensing and impose new restrictions under CCFPL for payday advances that involve repayments of $300 or less from a bank account.

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[49] In addition to the reasons discussed in these comments, we expect to be submitting comments to the Consumer Financial Protection Bureau with further analysis of why EWAs are loans under federal and state law.
[50] Calif. Const'n Art. XV, § 1(1).
[51] Calif. Const'n Art. XV, § 1(2).
[52] Cal. Civil Code § 1912. While the Constitution's 10% usury limit conflicts with and thus supersedes the 12% limit in the Civil Code, *see* Calif. Const'n Art. XV, the statutory definition of "loan" still informs the meaning of "loan" in the Constitution. *See also* Calif. Dep't of Business Oversight, OP 7667 – Deferred Payment Products (Dec. 19, 2019), https://dfpi.ca.gov/wp-content/uploads/sites/337/2019/12/Deferred-Payment-Products-cfl.pdf (finding that deferred payment products are consumer loans under CFL; reasoning that while the CFL does not include a definition of "loan," the definition of a "loan of money" found in Civil Code § 1912 should be used in defining the term "loan" for purposes of the CFL).
[53] *See generally* National Consumer Law Center, Consumer Credit Regulation § 3.9 (3d. ed 2020), updated at nclc.org/library.
[54] Milana v. Credit Discount Co., 163 P.2d 869 (Cal. 1945) (citing cases).
[55] Calif. Const'n Art. XV.

Payday advances are "credit" under the CCFPL and within DFPI's authority, as they are "the right granted by a person to another person to defer payment of a debt, incur debt and defer its payment, or purchase property or services and defer payment for those purchases."[56] Consumers who use the apps incur "debt," which is "any obligation of a person to pay another person money regardless of whether the obligation is absolute or contingent, has been reduced to judgment, is fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured and includes any obligation that gives rise to right of an equitable remedy for breach of performance if the breach gives rise to a right to payment."[57] Consumers are obligated to repay payday advances through payroll deductions, bank account debits, or other means. .[58]

But any application of CCFPL should be an interim measure until DFPI clarifies that payday advances must obtain CFL licenses. The CCFPL does not give DFPI the authority to disregard the application of other regimes that contain important consumer protections, most notably, usury limits. Indeed, the CCFPL does not have the authority to establish a usury limit applicable to credit except as otherwise provided by statute.[59] The CCFPL authority is no substitute for usury caps.

7. DFPI Risks Encouraging Evasions of Credit and Fair Lending Laws if it Succumbs to Entreaties to View "Innovative" Products as Outside Consumer Protections for Credit

The importance of viewing payday advances as credit goes well beyond the products discussed in these comments. The same arguments that these companies use to claim that they are not covered by credit and usury laws are being used by other types of products. If DFPI accepts the notion that certain features take a product outside of credit laws, there is no end to the creativity ("innovation") that companies – including predatory lenders – will use to evade consumer protections and usury laws.

Importantly, the price of a product is typically not a factor in assessing whether it constitutes credit. It may be tempting to say that a product that charges only $1 is not credit and should not be covered by usury laws. But if the product is not credit, it does not matter if the price is $1 or $100 or $1,000. Once the camel's nose is under the tent, the price will explode – if not at these companies, then at others with more predatory business models.

It is not clear if DFPI has any authority to regulate or limit the price of products if they are registered under the CCFPL rather than licensed under statutes with usury limits. As noted, DFPI does not have the power to impose another usury cap. If it attempts to use other authority to limit prices, it may be challenged.

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[56] Calif. Financial Code § 90005(g).
[57] Calif. Financial Code § 90005(h).
[58] Indeed, California's definition of debt also brings payday advances within the federal Truth in Lending Act. TILA has the same definition of "credit" as the CFPI, but neither TILA nor Regulation Z defines "debt." Regulation Z states that words not defined have the meanings given to them by state law or contract. 12 C.F.R. § 1026.2(a)(27)(i)(D).
[59] Calif. Financial Code § 90009(f)(3).

The current explosion of high-cost rent-a-bank lending by online lenders that are evading state usury laws[60] is an instructive example of how an "innovation" that began with mainstream pricing has exploded into predatory lending. The roots of today's rent-a bank problem begin with the use of bank partnerships in marketplace lending. Initially, mainstream companies like Lending Club and Prosper used bank partners to enable a national lending model that did not require state licensing or compliance with state usury caps. As those models expanded with little pushback, higher-cost lenders followed suit. They started with Elevate's Elastic line of credit, which does not disclose an APR. Then, little by little, rent-a-bank schemes involving very high-cost installment loans with APRs of 160% to 180% emerged, in blatant defiance of state usury laws. Today, we face a potential explosion of these models. And the predatory rent-a-bank lenders are using the exact same arguments refined by the mainstream lenders about why banks need to be able to sell assets in order to manage liquidity, and how bank involvement means that the bank, not the predatory lender, is the true lender.

The claim that payday advances are "nonrecourse," and that they are thus not credit, is also one that can be and is being used in other settings. As discussed below, that is part of the argument being made about why income share agreements are not credit.[61] Similarly, DFPI (when it was the Department of Business Oversight (DBO)) took the position that litigation advance products were credit under CFL despite nonrecourse claims being made by the lenders. While DBO entered into several settlement agreements with those companies, it required APR disclosures, imposed several requirements on the lenders, and reserved the right to assert that CFL applies.[62]

But as technology and innovation evolve, it is increasingly possible for lenders to be assured of repayment without having to resort to classic debt collection practices or lawsuits against consumers. If lenders feel confident that they can grab funds from a paycheck,[63] a bank account, home equity, or other security and have no real risk, they can forgo other types of "recourse."

Payday advances also rely on the claim that they are merely doing "factoring" and a sale transaction rather than a loan. Structuring a loan as a sale is a time-honored form of usury evasion.[64] We are already seeing numerous types of fintech "finance" products that claim to be

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[60] *See* National Consumer Law Center, High-Cost Rent-a-Bank Watch List, https://www.nclc.org/issues/high-cost-small-loans/rent-a-bank-loan-watch-list.html.

[61] *See, e.g.,* Morrison Foerster, Regulatory Treatment of Educational ISAs Under Federal and Select State Consumer Credit Statutes (March 2019), https://media2.mofo.com/documents/190408-regulatory-educational-consumer-credit-statutes.pdf.

[62] Litigation advances may also well be loans, and they can present an array of concerns. But there also may be significant differences between litigation advances and earned wage access products. Litigation can be highly uncertain, with a significant chance of losing a case and never repaying an advance. But failure of a payroll deduction after earnings have been verified is quite rare.

[63] *See, e.g.,* Anish Acharya, Seema Amble, and Rex Salisbury, Andreessen Horowitz, The Promise of Payroll APIs (Oct. 20,, 2020), https://a16z.com/2020/10/20/payroll-apis/, ("Further, when loan repayments are pulled directly out of a consumer's paycheck, called payroll-attached lending, it de-risks a loan significantly. It is akin to a loan that is securitized with a consumer's income stream, or by factoring a consumer's paycheck, rather than a true unsecured loan where the lender depends on the customer's willingness to repay. This sort of "voluntary garnishment" can reduce losses for lenders … [P]ulling directly from payroll puts the lender in question at the top.").

[64] *See, e.g.,* Scott v. Lloyd, 34 U.S. 418 (1835) ("The purchase of an annuity or rent charge, if a bona fide sale, has never been considered as usurious though more than six percent profit be secured. Yet it is apparent that if giving this form to the contract will afford a cover which conceals it from judicial investigation, the [usury] statute would

sales, not loans. These include not just earned wage access products and income share agreements but also "shared home appreciation finance" products that evade consumer protections for mortgages, including underwriting requirements and counseling requirements for reverse mortgages.[65]

DFPI should not countenance these evasions. If a "nonrecourse" clause or a "factoring" sale made a loan not a loan, it also would not need to be limited to earned pay. Payday lenders, high-cost installment lenders and others could "purchase" future wages and escape all lending laws.

A host of consumer protections in our credit laws will be lost if DFPI starts down the path of treating products as something other than credit. California is often a leader for the nation. It influences how products are viewed and how they should be treated. California must be a model that stands firmly on the side of preventing evasions of consumer protection laws.

8. The Increasing Trend Toward Free Early Pay Options Emphasizes that DFPI Should Not Distort Credit Laws to Facilitate Paid Ones

For a variety of reasons, the trend is for early pay options to be offered free to employees. While even free early pay can cause problems for workers, as discussed above, at least there are no added costs, and no risk of evasion of usury laws. Free products also do not appear to use bank account debiting, with the risk of overdraft and NSF fees. This trend towards free products highlights why it is unnecessary for DFPI to take the risk of evasions in order to make allowances for models that impose costs on consumers.

Payday advance companies claim that employers who offer early pay see reduced turnover, more motivated employees, and increased productivity.[66] They urge employers to offer the product as a benefit to employees. If offering early pay truly benefits employers, then employers should pay for it and offer it as a benefit.

Indeed, the number of free options is growing.[67] For example, FinFit's Wage Now product is completely free to employees.[68] FlexWage and PayActiv also offer free early wage access when the employer picks up the cost.

Some payroll companies are also offering free early wage access at no cost to either the employee or the employer as an enhancement of their payroll offerings. Gusto, for example, a

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become a dead letter. Courts therefore perceived the necessity of disregarding the form and examining into the real nature of the transaction. If that be in fact a loan, no shift or device will protect it.").

[65] *See* Lauren Saunders, National Consumer Law Center, Fintech and Consumer Protection: A Snap Shot at 15-16 (March 2019), https://www.nclc.org/images/pdf/cons-protection/rpt-fintech-and-consumer-protection-a-snapshot-march2019.pdf.

[66] *See, e.g.*, https://www.payactiv.com/employers/.

[67] *See* Leslie Parrish, Aite, Making Ends Meet: On-Demand Pay and Employee-Based Loans at 12-14 (Feb. 2021) (describing pricing structures of various companies).

[68] https://www.finfit.com/wagenow/.

payroll provider that focuses on small businesses, offers free early pay to its payroll customers.[69] Gusto's CashOut is offered transparently as a loan.[70]

A number of other companies offer free early pay options through their debit card programs as a benefit of the account. Examples include Branch, Ceridian, Instant Financial, Lyft Direct, Uber Visa Debit Card and the PayActiv debit card. FlexWage also offers early free access to tips, bonuses and other one-time pay directly deposited to its cards.

Even free forms of credit may, at times, be covered by credit laws and require licensing.[71] But at least the free models do not impose costs on consumers or risk evasions of usury laws.

9. Recommendations

In order to remain faithful to the requirements of existing California law, to prevent evasions of consumer protections, and to protect consumers, we recommend that DFPI do the following:

- Require that any payday advance product that debits bank accounts for amounts up to $300 obtain a license under the CDDTL and comply with the requirements of that Act, with additional requirements imposed under the CCFPL discussed below. Those that make bank account debits greater than $300 must obtain a license under and comply with the CFL.
- Clarify that payday advances that do not debit bank accounts are consumer loans and must obtain a license under and comply with CFL.
- Make clear that usury laws cannot be evaded through purportedly "voluntary" payments. "'[V]oluntary' payments of interest do not waive the rights of the payors" to enforce usury laws,[72] and calling the payments "tips" rather than "interest" does not change their character.

Given the trend towards free early wage access products, the other options that employers offer such as savings programs and affordable small dollar loans, and the uncertain benefit that payday advance products pose, we do not believe that requiring compliance with usury laws will deprive consumers of access to useful options to meet expenses.

In addition, for payday advance products covered by CDDTL, which are not exempt from CCDFL, in order to prevent unfair, deceptive and abusive practices, DFPI should impose the same rules that the CFPB did for loan sequences where the payday lender does not underwrite the loans for ability to repay:

[69] https://gusto.com/product/cashout.
[70] https://support.gusto.com/benefits/gusto-wallet/cashout/1532856101/Cashout-employee-overview.htm.
[71] Some credit laws do not apply if the credit is free. But even free loans are subject to some lending laws. *See, e.g.*, Calif. Dept. of Business Oversight, Press Release, Point-of-Sale Lender Sezzle Agrees to Cease Illegal Loans, Pay Refunds in Settlement with the California Department of Business Oversight (Jan. 16, 2020), https://dfpi.ca.gov/2020/01/16/point-of-sale-lender-sezzle-agrees-to-cease-illegal-loans-pay-refunds-in-settlement-with-the-california-department-of-business-oversight/.
[72] Stock v. Meek, 35 Cal.2d 809, 817, 221 P.2d 15, 20 (1950); Buck v. Dahlgren, 100 Cal.Rptr. 462 (Ct. App. 1972).

- No more than three consecutive advances,[73]
- That must diminish in size by a third (i.e., $150, $100, $500)
- Followed by a cooling-off period of 30 (or, better yet, 60) days
- With no more than six advances per year.

These limits may not be necessary for irregular payments such as tips, bonuses, or commissions as long as there is no fee. But for regular paychecks, this type of protection is needed to ensure that consumers do not end up in a debt trap of endless early wage advances, each with a fee, that are needed merely to fill the hole from the prior advances. The legislature also must reform the CDDTL to lower significantly the outrageous rates that payday lenders can charge.

If for some reason DFPI determines not to require CDDTL or CFL licenses, these products are still loans. Acknowledging that EWAs are credit is important for the reasons discussed in these comments – not only for payday advance apps, but also for DFPI's authority over various forms of credit, however styled. For EWAs that operate through payroll deduction or direct deposit offsets, if DFPI decides not to require CFL licenses and instead to register them under the CCFPL, the Department must at a minimum impose price limitations that prevent evasions of the CFL or constitutional usury caps. The DFPI does not have the authority to "establish a usury limit … except as otherwise provided for by statute."[74] The CFL provides for such a usury limit. And if the CFL does not apply, then the constitutional 10% usury limit applies.

Thus, any alternative CCDFL registration regime for EWAs that avoids existing licenses should be limited to products that:

- Are employer-based,
- Are integrated with the employer's time and attendance process,
- Do not debit bank accounts,
- Do not result in payroll deductions or other reductions in pay greater than $300 per pay period, including any fees,
- Have fees or charges, whether voluntary or not, that total no more than $5 per month, and
- Comply with the step-down, cooling-off provisions detailed above.

Products that debit accounts must be licensed under CDDTL or, if the debit is over $300, CFL. These limits are necessary to ensure that CCFPL registration does not provide an avenue to avoid otherwise applicable consumer protections. But it for some reason DFPI decides not to require CDDTL licenses, it must either state that the constitutional usury cap applies or impose the same $5 per month limit to prevent significant evasions of California's usury laws.

10. DFPI Must Avoid Allowing Interim Steps to Be Misconstrued or Misused as Endorsement

[73] By advances, we are not including bank account, debit card or prepaid card programs that do not charge any fee for immediate funds availability before a pending ACH transaction settles.
[74] Calif. Financial Code § 90009(f)(3).

We understand that DFPI might decide to enter into additional MOUs or even to establish interim registration requirements in order to collect data before it fully determines whether existing statutes apply or what new requirements should be imposed. As noted above, we appreciate the fact that DFPI's EWA MOUs do not foreclose the Department from regulating EWAs as credit or from establishing different or additional rules that go beyond current industry practices.

Nonetheless, it is essential that DFPI be careful both in its own messaging and in its agreements with companies to prevent misuse and misinterpretation of early DFPI comments. The EWA MOUs, for example, send the wrong signal, and we believe they are being misused.

DFPI's press release states that the agreements reflect an approach that "encourages responsible innovation." That statement could be read to imply that DFPI has concluded that all five companies covered by the MOUs represent "responsible innovation" of the type that should be encouraged.

Similarly, we have reason to believe that some of the companies may be using the MOUs to argue to policymakers in other states that California has reached the conclusion that these products, including the direct-to-consumer ones, are not offering credit. The general tone of the press release and the omission of any mention of the possibility of credit laws applying contribute to this impression.

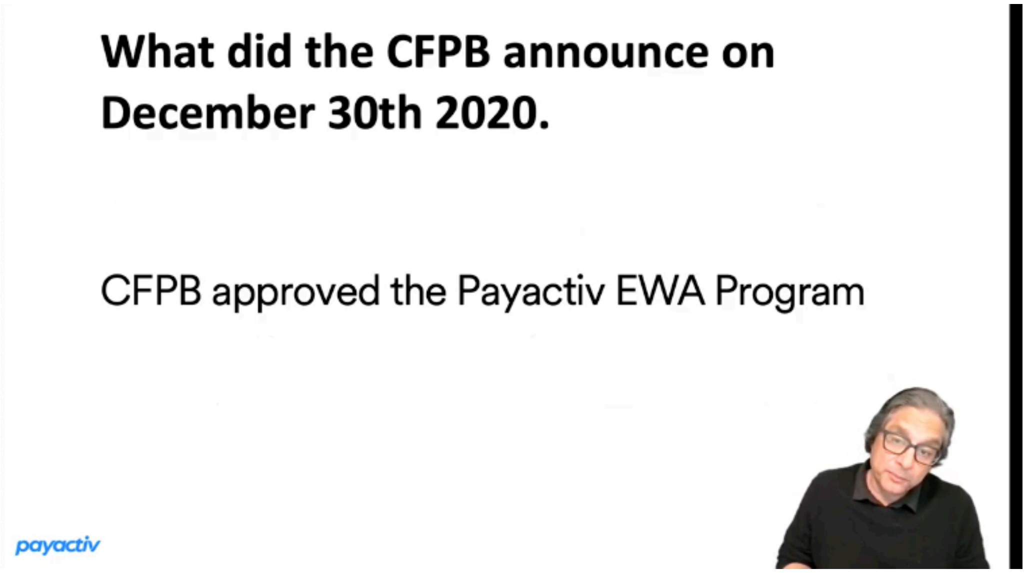
The MOUs themselves have some terms that limit misuse, but not enough. Each company agrees to "refrain from representing *to its customers* that it is supervised, approved, or endorsed by the Department in any way." But the MOUs do not prohibit the companies from representing to policymakers and employers in other states that California has endorsed them. We believe that is happening.

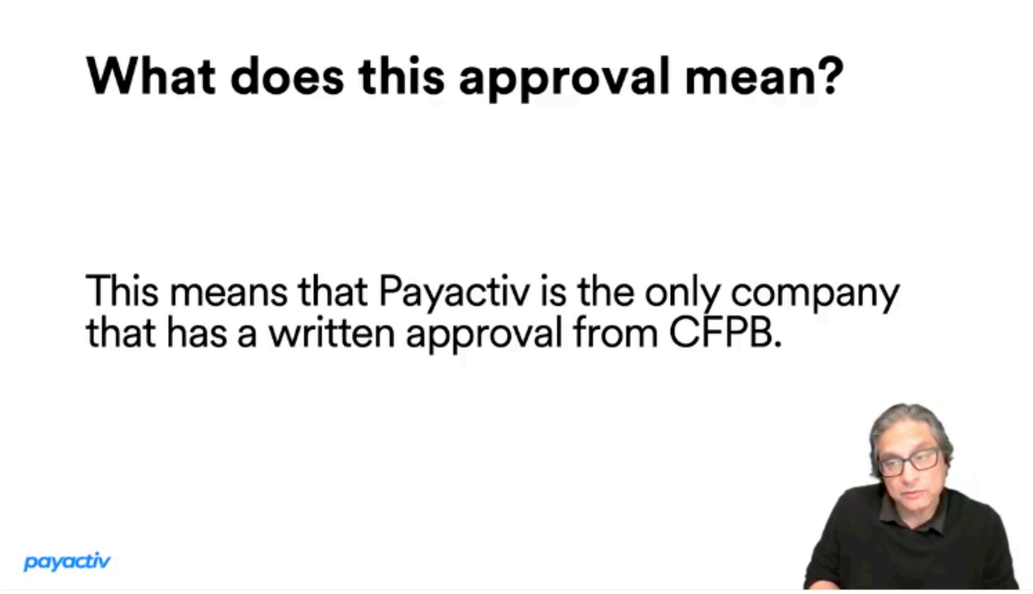
The MOUs also state that nothing in them "shall be interpreted as the Department's approval of the Company's business model or conclusion that the model complies with state or federal law." Yet the use of the passive tense, and failure to include a prohibition on misrepresentation, may provide wiggle room for the companies to promote that false interpretation outside of strictly legal settings.

The misuse of the CFPB's recent actions on earned wage access products illustrate the dangers of failing to control use of one's good name. The CFPB issued an "Approval Order" governing only "described aspects" of only some PayActiv's EWA programs and only certain legal questions. Yet PayActiv is using the order to imply much broader CFPB approval and endorsement. PayActiv is also taking advantage of the confusion between the lay meaning of "approval" and the specific legal meaning the CFPB intended for purposes of triggering statutory liability protection.[75]

Here are some examples:

[75] 15 U.S.C. § 1640(f).


What did the CFPB announce on December 30th 2020.
CFPB approved the Payactiv EWA Program
payactiv


What does this approval mean?
This means that Payactiv is the only company that has a written approval from CFPB.
payactiv

On one occasion, PayActiv was forced to correct a press release and to change "approved" in this statement and a second one to instead refer to an "Approval Order": PayActiv is "the only vendor with an EWA program specifically approved by the Consumer Financial Protection Board [sic] (CFPB)"[76]

PayActiv lobbyists are also touting the CFPB approval order to push for damaging changes to state usury laws, with no fee limits, to exempt payroll deduction loans well beyond the free or lower-cost products addressed by the CFPB.

California is often a leader for the nation. The signals it sends matters. As DFPI carefully considers data and public input in deciding how to regulate new types of products, it must not let its early steps be misused to lead others in the wrong direction.

[76] *Compare* PayActiv, Press Release, Correction – PayActiv (Mar. 3, 2012), https://apnews.com/press-release/pr-newswire/business-personal-loans-personal-finance-1d3b91c8f222a5424bf7e54a357001df *with* Hancock Whitney Bank Offers PayActiv EWA Program to Business Clients (Mar. 2, 2021), https://finance.yahoo.com/news/hancock-whitney-bank-offers-payactiv-110000833.html.

11. DFPI Should Seek Public Input Before Entering into MOUs or Other Interim Steps with Other Industries

We strongly urge DFPI to seek broader input before entering into MOUs such as the EWA ones. It is essential to consider alternative views on what products are "innovative" and should be "encouraged," what messages to send on interim actions, what early steps should be taken to protect the public, and ultimately how they should be regulated. While we have provided some views on two products in this memo, others should also be given the chance to express their views before the Department takes additional significant actions. DFPI, and the broader public, are best served when the Department has full information and does not solely rely on the representations made by companies that have the resources to hire lobbyists, lawyers and others to pitch their products.

Conclusion

Thank you for considering our views. If you have questions, please contact Lauren Saunders at lsaunders@nclc.org or Marisabel Torres marisabel.torres@responsiblelending.org.

Yours very truly,

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