Responses to NCOIL EWA Questions from the Center for Responsible Lending and National Consumer Law Center

July 12, 2024

1.) Please explain how the following can be true: If the EWA industry allegedly has no mandatory fees, how did "California find the annual percentage rate (APR) in California was ~330% across the industry?" (quote is taken from the chat during the Zoom meeting on May 31, 2024).

Earned wage advance lenders claim that the fees they charge are optional but structure their transactions to pressure users into paying to access their own wages. Many of these companies advertise their products as "free" or "0% interest" while obscuring the ways in which they earn fees from users: expedite fees to receive quicker access to cash and so-called "tips." Both are properly included in APR calculations. Expedite fees must be included because the vast majority of users pay them when required for instant access (after all, the purpose of an earned wage advance loan is quick access to cash). And "tips" are also properly part of the cost of these loans because EWA lenders use a host of behavioral economics pressure tactics to induce users to tip.[1] The California Department of Financial Protection and Innovation ("DFPI") found that, due to these tactics, companies that solicit tips receive a tip for nearly 75% of transactions.[2]

The DFPI calculated APRs through a simple calculation based upon the size of the advance, cost of the advance, and time to repay the advance. The Department used the recognized formula for APR calculation used across the financial services industry, and arrived at the following conclusion: "The average annual APR was 334% for tip companies and 331% for the non-tip companies."[3]

Earned wage advances provide very little credit – small amounts for a short amount of time – and that is why the APR is high. It costs ten times more to borrow $100 for 10 days using a 300% APR loan than a 30% APR one. Whether $20 is a lot or a little for a taxi ride depends on whether you are going one block (or taking several one-block rides) or 10 miles.

2.) Why should or why shouldn't these products be categorized and regulated as a loan?

A loan is simply an agreement to receive money now and pay it back in the future, either with or without an additional fee paid to the lender. In every other context, we call such an agreement a loan, and earned wage advances are no different.

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[1] Screenshots of EWA apps showing these pressure tactics may be viewed on page 5 of the following research report from CRL: https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-ewa-brief-oct2023.pdf.

[2] Cal. Dep't of Fin. Prot. and Innovation, 2021 Earned Wage Access Data Findings (March 2023) at 7, *available at* https://dfpi.ca.gov/wp-content/uploads/sites/337/2023/03/2021-Earned-Wage-Access-Data-Findings-Cited-in-ISOR.pdf.

[3] *Id*. at 1.

It is critical that these products be regulated as a loan because in most states that is the key definition that triggers important consumer protections, including the vital protection of cost limits such as interest rate caps. Unlike most products, loans are nearly always subject to cost caps because those products can effectively create their own demand and trap users in a cycle of debt and reborrowing. Without effective cost caps, lenders take advantage of desperate, marginalized consumers by trapping them in unaffordable loans designed to get the consumers to take out *additional* loans in the future that put them only further and further behind.

Earned wage advance loans are no different. Consider a user living paycheck to paycheck who needs $50 before payday. If that user takes out an EWA loan for $50, pays a $4 expedite fee, and tips $3 (these are relatively small costs for this industry), the user will have $57 less than usual on payday. Very often, of course, the consequence will be that the user will have yet another shortfall the next pay cycle that will require them to borrower again and incur additional fees that push the user further and further behind. Given this dynamic, it is not surprising that the California DFPI found that users *on average* used these products 36 times per year.[4]

The payday loan industry exists because decades ago their lobbyists convinced lawmakers that they were not making loans, they were just charging "check cashing fees" on "deferred presentment" of checks. We must not make that mistake again.

3.) Why should or why shouldn't these products be subject to state usury laws?

State usury laws principally regulate the amount that borrowers pay to access credit. As discussed above, it is critical that usury limits apply to EWA transactions to protect vulnerable borrowers from being trapped in an expensive cycle of reborrowing that puts them further and further behind.

4.) If all state EWA laws require companies to offer a free option, why should the Model be any different?

A free option that is not used by most borrowers because it is slow and inconvenient does not justify exempting costly products from existing laws governing credit, and in particular cost limits on those transactions. As noted above, users nearly always pay expedite fees when required to get quicker access to fund. Thus, lenders offer a free option principally to try to justify advertising these transactions as "free" or "0% interest" to lure the user down the transaction pathway before they realize the true cost of the product (in this way, the business model is similar to hotels that hide a "resort fee" until the final screen of the booking page).

If, on the other hand, earned wage advances must comply with the cost limits that apply to all other extensions of credit then consumer advocates have no objection to offering a free option. But the free option cannot justify exempting these transactions from credit laws.

5.) When a free option is utilized, how is the EWA product any different than Venmo?

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[4] *Id*. at 11.

Venmo is an inapt comparison to EWA loans. Most important, Venmo users who transfer funds to their bank accounts are *actually accessing their own money*. By contrast, EWA users who take out an advance receive *the money of an EWA lender* and agree to repay that advance as a later date. Wages are not your money until payday. This is not a mere technical distinction. Unlike Venmo transfers, EWA advances are later closed out by the borrower repaying the advance, either through payroll deduction or debiting of the user's bank account. Repayment can have knock on effects including overdraft fees. Indeed, new research from CRL revealed that users' incidence of overdrafting their checking account actually *increased* after they started to use an EWA product.[5]

In addition, EWA loans involve the user receiving money that they have not already been paid, unlike a Venmo transfer. In effect, EWA users borrow money they are scheduled to receive in the future. When they do so, they receive less money in the future and leave themselves vulnerable to being trapped in a cycle of reborrowing when faced with future expenses. EWA loans trap users in a cycle of reborrowing; Venmo does not.

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[5] *See Not Free: The Large Hidden Costs of Small-Dollar Loans Made Through Cash Advance Apps*, CRL (April 2024), *available at* https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-not-free-hidden-costs-apr2024.pdf