

**NEW CONSUMER FINANCIAL PRODUCTS AND THE
IMPACTS TO WORKERS**

HEARING
BEFORE THE
COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE
ONE HUNDRED SEVENTEENTH CONGRESS
SECOND SESSION

ON

EXAMINING NEW CONSUMER FINANCIAL PRODUCTS, THE STRUCTURE
OF NEW CONSUMER FINANCIAL PRODUCTS, EXISTING REGULATORY
AND LEGAL FRAMEWORKS, AND THEIR IMPACT ON HOUSEHOLDS

SEPTEMBER 13, 2022

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NEW CONSUMER FINANCIAL PRODUCTS AND THE IMPACTS TO WORKERS

TUESDAY, SEPTEMBER 13, 2022

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:15 a.m., via Webex and in room 538, Dirksen Senate Office Building, Hon. Sherrod Brown, Chairman of the Committee, presiding.

OPENING STATEMENT OF CHAIRMAN SHERROD BROWN

Chairman BROWN. The Committee on Banking, Housing, and Urban Affairs will come to order. We apologize for the delay this morning. We do not like to start the hearing late but sometimes we have to.

So we thank the four of you for joining us. Good to see all of you. Some of you have been in front of this Committee before or have worked around here before, so welcome, especially to those of you.

This hearing is in a hybrid format. Our witnesses are in person. Members have the option to appear in person or virtually.

Hard work should pay off for everyone. That is the American dream. That is what the dignity of work is all about. It is a concept that Pope Leo XIII spoke of in the late 19th, early 20th centuries, and a concept popularized by Dr. King.

And when work has dignity, you can support yourself, your family, and your future. But we all know what has happened over the last four decades. Corporate profits have gone up. The stock market has soared. Executive compensation has exploded.

But wages have not kept up with the cost of living. Millions of workers with full-time jobs who aspire to the middle class cannot join it, no matter how hard they work. And even people we may define as middle class do not feel much security and stability.

And when workers are forced to find ways to make up for the gap between what they are paid and what they should earn, what are they left with?

Debt.

Sometimes people will have to borrow money. Products that are well-designed, transparent, and regulated can help workers pay off an unexpected car repair, or help with the grocery bill, or cover a medical expense.

But as we heard at our listening session with workers last week in this Committee, too often these products are not well designed, they are rarely transparent, and they are not well regulated.

For too many workers, the only credit products available lead to more debt and more financial instability. We have discussed in this Committee the impact predatory payday lenders have on working families.

Today, we examine the impact some newer consumer financial products have on workers. Companies tell us these new products are innovative, they are easy to use, they will give people more options. But so often, “innovation” is just a new way for companies to make money, while trapping people in debt.

Newer credit products, like “Buy Now, Pay Later,” could help consumers pay for products in installments, with strong consumer protections.

Yet many of these products come with hidden fees, they lack transparency, and they are not underwritten properly. Ads encourage consumers to use these plans for multiple purchases, at multiple online stores, racking up debt they cannot afford to repay.

Consumers like Briana Gordley. As a college student, Briana started off with one of these loans. First one BNPL company, then two, then three. One company told her they were raising her credit limit from \$100 to \$1,000.

Initially, 18-year-old Briana was not too concerned. As she put it, if the companies “believed in my ability to repay my debt, then I did too.” With the approval of more and more credit, Briana was juggling \$1,500 in loans with different payment dates throughout the month, and her account kept getting overdrawn.

Briana’s story gets to the core of the problem. With little to no underwriting, the “Buy Now, Pay Later” companies do not know if they are the only ones a consumer has credit with. And without proper term disclosures, a consumer is left in the dark.

For this model to work for consumers, we need real rules companies must follow, and we need proper disclosures.

Then there are new consumer products that use a so-called “tip model,” structuring themselves to deliberately avoid disclosing their terms, specifically avoiding important disclosures required by the Truth in Lending Act. Products like cash advances, overdraft coverage, and Earned Wage Advances—that are not offered in conjunction with employers—use a model where consumers are asked to pay a “tip” to the lender, instead of a fee or interest rate to use the products.

Companies claim that because a tip is not presented as a finance charge or interest rate, Truth in Lending and other consumer protection laws, like the Military Lending Act, do not apply. The tip is just “voluntary,” they say. But these tips are not voluntary at all. It is just a way to cheat the system and hide the true cost to workers.

Employer-based Earned Wage Advances with strong consumer protections can help workers cover unexpected expenses or emergencies, though the better alternative would simply be for the companies to pay their workers enough to live on.

And then there are debt products that are so predatory, so offensive, they should have no place in our financial system, schemes like Training Repayment Agreement Provisions, appropriately known as “TRAPs.”

I will say this for that term that was invented—it is truth in advertising. These provisions in employment contracts allow employers to recoup the cost of training employees who leave the job. It is an offensive concept.

It is the employer's job to train their workers. On-the-job training is not some special perk for workers. It is a smart investment for companies.

TRAPs require workers to pay back their employers for training if they leave their job within a certain period of time, saddling workers with debt. It is just a modern-day version of the scrip that left coal miners exhausted, destitute, and trapped by their employers.

Remember what Tennessee Ernie Ford sang about owing his soul to the company store: "You load 16 tons, what do you get? Another day older and deeper in debt."

Employers use TRAPs to prevent workers from pursuing higher paying or better opportunities. They decide how much the training would supposedly cost on the market and go after their workers, threatening their credit and economic mobility.

Last week, Cassie Pennings from Colorado told Members of the Committee about her experience with TRAPs. Ms. Pennings pursued her calling as a nurse during the COVID-19 pandemic. At the start of her job, her employer made Ms. Pennings sign an employment contract, and buried in the fine print, it said that if she left before 2 years, she would be indebted to her employer for \$7,500 for the supposed training they provided.

When Ms. Pennings decided to leave her nursing job after a year because of a bad work environment, her employer took \$1,000 out of her second-to-last paycheck to pay back her "training." That was half of her paycheck. Her former employer told her they will send the rest of the amount to collections. Last I checked, indentured servitude was illegal in the United States, but it looks like some enterprising companies are rebranding it, with these new employment contracts.

And that is the focus of today's hearing, to ensure that so-called "innovation" is not a substitute for good pay and does not come at the cost of workers' dignity of work.

Senator Toomey.

OPENING STATEMENT OF SENATOR PATRICK J. TOOMEY

Senator TOOMEY. Thank you, Mr. Chairman and thank you for kindly delaying the start of this hearing. Thank you to the witnesses for your patience. I was unavoidably delayed. I appreciate the accommodation.

Today's hearing, of course, is about new consumer financial products. In the last decade, we have seen financial institutions develop technology-oriented solutions to meet consumer needs. These new choices create a more competitive marketplace—all to the benefit of consumers.

As long as consumers have truthful and accurate information about financial products, it is the consumers who are best positioned to decide what products to use. Any regulation of financial products should fit the product type, make room for innovation, and maximize consumer choice. Too often, however, the response

from some of my friends on the other side of the aisle is to see something new and panic.

Let us talk about some of these new products. One of them, is called “Buy Now Pay Later,” or BNPL. BNPL typically allows consumers to make purchases now, often online, and repay them in four interest-free installments later.

This service can be a very attractive way for consumers to manage their cash-flows to obtain goods and services without having to pay interest. That is especially true for consumers who do not have or do not want to use a credit card for such purchases. This may explain why BNPL is most popular among younger consumers, who have shorter credit histories. If customers are late with payments, BNPL companies sensibly suspend further purchases until they are paid, and some charge a late fee. Interestingly, BNPL companies do not primarily make their money from consumers at all, but rather from retailers, who pay them a small percentage of transactions to offer the service to customers. Retailers are willing to do this because they do not have to pay credit card interchange fees on BNPL payments, and offering BNPL can increase sales and customer loyalty.

Another newer financial product that provides consumers with short-term funding is Earned Wage Access, or EWA. This service can be an appealing alternative to payday loans for workers who want an advance on their wages. Many people do not have savings available to pay for unexpected expenses that can arise in between pay periods, like car repairs or medical bills. EWA can help consumers to meet such expenses and others by advancing them the amount of income they have already earned at that point in the pay period.

There are various EWA products available. In some cases, employers select and pay the fee for the service as an employee benefit, while in others, consumers must pay the fee.

According to a recent study, the average fee a user paid per advance was \$2.59 to \$6.27. That is less than 5 percent of the amount advanced.

In short, marketplace competition has successfully generated more and cheaper options for many consumers to meet their needs. This is a reminder that market competition is typically better at helping consumers than the Government, whether the product or service is in the financial sector or some other category.

Other newer financial products include forms of credit that have existed for a long time, but with innovations in how they are provided. In recent years, financial institutions, primarily community banks, have begun to partner with financial technology companies, or fintechs, to offer improved products and reach more consumers.

Bank-fintech partners offer a large variety of credit products, including small-dollar, personal, auto, and small business loans, as well as credit cards, mortgages, and home equity credit lines. These partnerships can generate significant consumer benefits by lowering the price of financial products, expanding consumer choice, and increasing competition. Often they provide access to credit for higher-risk borrowers, such as consumers with lower incomes or no credit histories, all through a highly supervised financial institution.

Unfortunately, some bureaucrats and some lawmakers react with hostility to almost any new financial products. Democrats in Congress have pejoratively branded all bank-fintech partnerships, in general, as “rent-a-bank” schemes. Last year, they overturned an OCC rule that provided regulatory certainty for these partnerships. Unfortunately, by attacking legitimate bank-fintech partnerships, our Democratic colleagues risk restricting access to needed credit for lower-income consumers.

And then there is the CFPB. Under Director Chopra, the CFPB has repeatedly demonstrated hostility to innovation in consumer finance markets. For example, Director Chopra has replaced the CFPB’s Office of Innovation with a new “Office of Competition and Innovation” in order to advance his efforts to involve the CFPB in antitrust and competition law, which is outside its jurisdiction. He also sidelined the Office of Innovation’s programs to foster responsible innovation, such as no action letters and regulatory “sandboxes.”

I am also concerned the CFPB will bring this reactive, anti-innovation perspective to its scrutiny of new financial products. Already, it has made public statements that suggest hostility toward BNPL and other products. All of this hostility to new financial products is further evidence of the condescension and paternalism that we see sometimes in financial regulation.

Individual consumers are better positioned than any bureaucrat or politician to understand their own individual needs and preferences, and to make their own choices. Some of my colleagues ignore the benefits consumers derive from access to more choices in a more dynamic marketplace.

The best form of consumer protection is a robust, competitive market. That is why instead of curtailing new financial products, regulation should facilitate innovation and consumer choice.

Thank you, Mr. Chairman.

Chairman BROWN. Thank you, Ranking Member Toomey. I will introduce the four witnesses. Left to right, Ms. Rachel Gittleman is the Financial Services Outreach Manager for the Consumer Federation of America. She leads CFA’s advocacy and outreach on high-cost lending, payday loans, and other banking and credit issues. Welcome, Ms. Gittleman.

Ms. Penny Lee is CEO of Financial Technology Association. She served previously as Chief Strategy Officer of 1776, a technology incubator. She previously served as senior advisor to Senator Majority Leader Harry Reid. Ms. Lee, welcome.

Professor Todd Zywicki is somewhat of a regular in this Committee. He is George Mason University Foundation Professor of Law at the Scalia School of Law. He is a senior fellow at Cato, chair of the CFPB Taskforce on Federal Consumer Financial Law in 2020. Mr. Zywicki, welcome.

Mr. David Seligman is the Executive Director of Toward Justice. He has litigated several class and collective actions to attack systemic injustices in the labor market. He clerked for Chief Judge Patti Saris of the District of Massachusetts. Mr. Seligman, welcome.

And Ms. Gittleman, if you would begin your testimony.

Thank you.

**STATEMENT OF RACHEL GITTLEMAN, FINANCIAL SERVICES
OUTREACH MANAGER, CONSUMER FEDERATION OF AMERICA**

Ms. GITTLEMAN. Chairman Brown, Ranking Member Toomey, and Members, thank you for the opportunity to testify before you today. I am Rachel Gittleman, Financial Services Outreach Manager at Consumer Federation of America, a nonprofit association of national, State, and local consumer groups focused on advancing consumer interests through research, advocacy, and education.

New consumer credit products are exploding across market areas. Some of the fee models, schemes, and provisions discussed today are inherently deceitful and predatory. Others may help certain consumers manage their finances but even those are not risk-free.

Regardless, at their core, each of the products discussed today are credit. They provide funding, or the promise of funding, today, and are repaid later, and should be covered by basic consumer protections at the State and Federal level, especially given that they are disproportionately used by and marketed to lower-income consumers and consumers of color.

Buy Now, Pay Later products allow consumers to pay a portion of a purchased item up front and the rest of the debt in three, often interest-free, installments over a set period. But they lack underwriting for a consumer's ability to repay, leading to unmanageable amounts of debts. Consumers can face cascading fees, negative credit reporting, debt collection, and difficulty with disputes and refunds.

Earned Wage Advance products are funds advanced by a third party to a consumer before their regular payday. Fee-based Earned Wage Advances are ostensibly a lower-cost form of a payday loan, requiring workers to pay to get paid, and they can lead to the same cycle of reborrowing as other balloon payment loans. Even free EWA products may still create a hole in next week's paycheck, leading to a cycle of debt.

Fake Earned Wage Advance overdraft protection and other cash advance products that collect tips are simply disguising finance charges under a new name. Tips are not truly voluntary, as they are structured so that it is difficult to avoid tipping. Consumers feel obligated to tip, like in a restaurant or service setting, but unlike those setting tips do not go to another human being but rather to the company's bottom line. The true cost is not true to consumers, and tips add up quickly, costly nearly as much as traditional payday loans in some instances.

Hidden deep inside employment contracts, Training Repayment Agreement Provisions trap consumers in low-paying jobs by requiring repayment of large fees for on-the-job training or orientations. This debt is enforced if a consumer leaves, either voluntarily or not, before an arbitrarily determined date. TRAPs indebted the consumer to the employer with the threat of high interest rates, attorney and collection fees, or withholding of other benefits.

Importantly, these products are credit and should be viewed and regulated as such. Failing to do so will lead to further evasions of credit laws. Therefore, CFA recommends that State and Federal regulators supervise fintech provider to ensure they are compliant with credit, fair lending, and consumer protection laws as well as

not engaging in unlawful discrimination or unfair, deceptive, or abusive acts or practices.

Regulators should closely examine evasive pricing models, providers should only offer products after determining a consumer's ability to repay, and loans should be structured in an affordable way with proportional penalty fee. The cost of credit should be portrayed to consumers as an annual percentage rate so that they can compare products. Consumer data should be used in a responsible, transparent manner. State and Federal regulators should collect, analyze, and publish data to better understand and illuminate the risks of these products. And State and Federal regulators should work together, across agencies and levels of Government, to ensure consumers are protected and predatory actors are held accountable.

Oversight is especially needed as each of these products is either disproportionately used by or marketed to low-income consumers and consumers of color. Without meaningful holistic underwriting, affordable repayment options, and price transparency, products may do more to exacerbate financial exclusion rather than promote financial inclusion.

Each of these products should not be allowed to use the guise of innovation, the cover of a lengthy employment contract, or a borrowed label to shield themselves from Federal and State oversight and regulation.

Thank you for your consideration, and I am happy to take any questions.

Chairman BROWN. Thank you, Ms. Gittleman.

Ms. Lee, welcome.

STATEMENT OF PENNY LEE, CEO, FINANCIAL TECHNOLOGY ASSOCIATION

Ms. LEE. Thank you, Chair Brown, Ranking Member Toomey, and Members of the Committee, today, for allowing me to testify. I am the Chief Executive Officer of the Financial Technology Association, a nonprofit trade association representing industry leaders shaping the future of finance.

As we have seen, fintech adoption has surged over the past few years. Nine in ten consumers use financial technology to manage their finances. Consumers confirm it saves them time and money. Seventy-three percent say it helps them make better financial decisions, and 71 percent say it helps reduce financial stress.

Today, unfortunately, Americans are more likely to report they are worse off financially than they were a year ago. With prices rising, millions continue to struggle to make ends meet, and cashflow stress makes it difficult for many Americans to cover essential costs while waiting on a biweekly or even monthly paycheck.

Fortunately, fintech is creating new tools for consumers to improve their financial security. Financial innovation allows the single mom the ability to buy medicine for a sick child or a parent the ability to purchase new school supplies that better fit their household budgets and finances.

I will focus my remarks today on a few particular areas of fintech innovation in the Buy Now, Pay Later, and Earned Wage Access spaces.

Buy Now, Pay Later, BNPL, is an alternative payment option enabling consumers to manage their cashflow and avoid paying high interest rates and fees. As you alluded to, the typical pay-in-four model provides small, low-cost, short-term payment options, usually four installments over 6 to 8 weeks, with no extra fees if the consumer pays on time. BNPL generates the vast majority of its revenue from partnerships with merchants, not consumer fees.

According to Morning Consult poll conducted on behalf of the FTA, more than three-quarters of BNPL users have a favorable opinion of the service and trust it to do the right thing for consumers. Seventy-seven percent of adults using multiple BNPL companies said it actually makes it easier to pay for purchases.

The Financial Health Network's recent study found that 99 percent of BNPL users understood the terms and conditions of the service, 96 percent had no difficulty making payments, and only 4 percent were late or missed one or more payments.

Importantly, BNPL also supports America's small businesses by enhancing the customer experience, facilitating economic activity, and driving consumer satisfaction. BNPL products are also subject to consumer protection regulations, including anti-money laundering, fair lending, debt collection, privacy, fair treatment of consumers, and electric fund transfers. They are also subject to similar State consumer protection laws.

I will switch now to another financial product that we mentioned, Earned Wage Access. EWA is a critical area of innovation that offers workers flexibility through on-demand and early access to their already earned wages, helping them make timely payments and avoid overdrafts and manage any short-term financial shock. EWA services can provide consumers with a more flexible and less-expensive way to avoid missing a bill or sliding into debt. Without these services, 44 percent of consumers would be unlikely to pay their bills on time, and 38 percent would consider going into overdraft.

EWA services are non-recourse and do not charge interest. That means consumers have no legal obligation to repay, and providers cannot take legal action to collect payments.

All EWA product models are subject to consumer protections, including fair treatment of customers laws, UDAAP laws.

On behalf of FTA's member companies I appreciate the opportunity to engage with the Committee today on these important issues. Fintech innovations are driving competition and providing consumers greater choice that results in lower costs and better financial outcomes. We strongly believe that balance and thoughtful regulation is key to long-term success for all involved stakeholders. I look forward to helping inform this important discussion today. Thank you.

Chairman BROWN. Thank you, Ms. Lee.

Mr. Zywicki, welcome.

STATEMENT OF TODD J. ZYWICKI, GEORGE MASON UNIVERSITY FOUNDATION PROFESSOR OF LAW, GEORGE MASON UNIVERSITY ANTONIN SCALIA SCHOOL OF LAW

Mr. ZYWICKI. Thank you, Chairman Brown and Ranking Member Toomey. It is a pleasure to appear with you again today. Thank you.

Fintech, I think, is a very exciting development generally, and I think the products that we are focusing on today, EWA and BNPL, are good examples of the potential for fintech to improve consumer welfare, especially with respect to consumers who traditionally have been excluded, who have thin files or no files for credit, and also importantly, are very important vehicles for promoting innovation but also competition against incumbent providers who can often get lazy if they do not have somebody nipping at their heels.

I think the reality in this country is that middle-class consumers do pretty well in consumer credit markets today. Obviously, there are issues around the margins, but with respect to mortgages, credit cards, and the like the markets are transparent, competitive, plenty of choice, plenty of innovation. Consumers have very little trouble finding the products they want.

But a perennial issue in American history is what to do with people who do not necessarily qualify for these top-notch and high-quality products that we have, and this has been an issue that has occurred again and again in America, and we see it with respect to the issues that these fintech providers are providing, which is, first, what to do with wage workers who live paycheck to paycheck—and life does not occur on 2-week cycles and sometimes you need money in between for bills and emergencies and the like—as well as people who have opportunities to purchase valuable products, and in particular consumer durable products can be seen as a capital good by a household. The value of a washing machine may be the most important investment you ever make in your life, if you think about the alternative being the schlep to the laundromat every weekend. And BNPL is a good example of that.

And so what a lot of these products are doing are basically providing very useful, low-cost, and convenient solutions to problems that have been around for a long time. BNPL can be seen as an update of the old personal finance company or retail installment loan. And EWA is a very good solution to the problem of what was originally wage loans, and now essentially are filled by payday loans.

And what we have recognized over time, and that history has taught us is innovation really is the way in which we have improved welfare for all American consumers, but particularly lower-income consumers. A good example was the development of credit scoring and credit reporting, systemized credit reporting systems in the '70s, which dramatically increased competition, expanded access to people who traditionally were not buddies with the bank manager and so could not get a credit card. And also especially for broke-down discrimination, and promoted equality in markets by basically getting rid of the old sort of ways in which lending was done and replacing it with FICO scores and other algorithmic lending.

And so I think there is great potential for these products. I think they have proven themselves. I think so far consumers have shown that they are using them in a very valuable way. EWA users report, at least, that they are less likely to take overdrafts, less likely to use payday loans, less likely to pay bills late. That is obviously worth monitoring, going forward, but they seem to be using it as an opportunity to smooth and sync up their income with their expenses.

BMPL, so far, is more of a frothy market so far, but so far it has really been a godsend, it seems, for a variety of reasons, which is, first, during the pandemic, BNPL purchases rose dramatically as people moved to online shopping, and it shows a very important flexibility in the consumer financial marketplace.

There has also been an especially high uptake by younger consumers, and younger consumers, nowadays, because of various reasons, including various regulations such as the Durbin amendment, the CARD Act, younger consumers have less access to credit cards and the like, less access to bank accounts and the like. And so I think BNPL has really stepped in to not only make it less necessary for them to access those products but also has allowed them to continue to shop and get the things that they need. So it has provided a useful solution to that.

And I think the final lesson I would say today is over time when new products emerge they tend to be somewhat frothy, and there tends to be a lot of variety in pricing. Over time, competition and innovation tends to lead toward more standardization on its own, and my big concern at this point would be premature regulations that freeze the market, that impose unnecessary costs where regulations may be archaic and designed for products that are not around anymore and ill-suited to this regulation.

So I want to close by commending the CFPB very strongly for starting off by issuing an RFI, starting with the research, understanding what these products are, who these consumers are, what the risks are, before plunging in. I think while we should have aggressive enforcement, consumer protection laws, I think we should be wary of premature regulation.

Thank you for the opportunity to appear today.

Chairman BROWN. Thank you, Mr. Zywicki.

Mr. Seligman, welcome. Good to have you.

**STATEMENT OF DAVID H. SELIGMAN, EXECUTIVE DIRECTOR,
TOWARDS JUSTICE**

Mr. SELIGMAN. Good morning, Chairman Brown, Ranking Member Toomey. I am the Executive Director of Toward Justice.

Some tout employer-driven debt as an innovation of corporate employers in the financial services sector that we should celebrate and seemingly insulate from regulatory oversight. They suggest that these forms of debts are essential to workers who need access to credit to ends meet, training to advance their careers, or the costs of starting up a job.

But workers' difficulty meeting financial demands and advancing professionally do not arise because they do not have access to credit. They arise because far too many workers still do not earn a living wage or have a predictable schedule that will allow them to

meet their most basic financial obligations. And far too many corporate employers, even as corporate profits balloon, seek to shift onto their workers their own costs, while undermining the most critical component of a worker's dignity and bargaining power, the ability to seek out other work that will pay them more and treat them better.

To appreciate the importance of oversight and vigorous enforcement of worker and consumer protections we should understand employer-driven debt, broadly. Employer-driven debt affects workers like nurse Cassie Pennings, whose story you heard earlier. Ms. Pennings contracted with a hospital where she worked, including a Training Repayment Agreement Provision, like the contracts of thousands and thousands of other workers—truck drivers, hair stylists, social workers, and employees of PetSmart, among others. By trapping workers in these jobs these arrangements run counter to the principles of fair competition that we have heard so much about today.

Employer-driven debt also affects the immigrant cleaning workers who come through my organization's doors, complaining that they were sold a sub- minimum-wage job, dressed up as a cleaning company franchise, and that, in told, they could finance the startup costs and franchise fees through their purported franchisor, who then trapped them in a vicious cycle of debt and modern-day indentured servitude.

Employer-driven debt affects countless retail and service workers whose work schedules are unpredictable and variable, making it hard for them to make ends meet. But instead of a fair schedule or a consistent living wage, their employer offers them short-term loans to bridge the gap, loans whose true costs are often not disclosed.

Workers cannot address the harms of employer-driven debt on their own. They are deterred by pervasive misclassification, forced arbitration clauses, and the threats that their employer will punish them through aggressive debt collection, whether or not the contractual provision permitting that collection would ever be enforced by a court.

It is imperative, therefore, that Federal agencies provide regulatory oversight and vigorous enforcement in this space. The Consumer Financial Protection Bureau can guard against unfair, abusive, and deceptive practices related to these products, look out for predatory employer-driven debt arrangements that target immigrants and people of color in violation of the Equal Credit Opportunity Act, and ensure that protections like the Fair Debt Collection Practices Act apply to employers' efforts to aggressively collect debts that trap workers.

Agencies like the FTC and Department of Justice can police and regulate the market for employer-driven debt that unfairly and illegally impedes worker mobility or even that keeps workers trapped in violation of laws, prohibiting trafficking and peonage.

Finally, when employer-driven debt seeks to recoup the employer's costs it may be an illegal kickback against workers' wages, in violation of minimum wage laws. In the case of Training Repayment Agreement Provisions, when, as is often the case, the underlying training is not principally for the employee's benefit but it is

instead standard training for the benefit of the employer, the employer-driven debt is likely a minimum wage violation. In these cases, the U.S. Department of Labor can ensure that employers do not keep workers trapped in jobs through threats to collect such debts.

Workers do not care if we understand their challenges as consumer protection challenges or labor challenges or competition law challenges. What matters to them is that Government is there to police abuses of corporate power and level the playing field.

We appreciate this Committee's attention to this important matter.

Chairman BROWN. Thank you, Mr. Seligman.

Some questioners may be hybrid. I am sure you are aware of that.

Let us start with Ms. Gittleman. With new consumer financial protections the Committee is discussing, to products the Committee is discussing today, it is important at the outset to establish what type of financial products that they are. So my question for you, Ms. Gittleman, first question, are Buy Now, Pay Later, Earned Wage Access, and other type of products that use the tip model you discussed, are they a form of credit that falls within the purview of existing consumer protections?

Ms. GITTLEMAN. Yes. Thank you for the question. Each of the products discussed today are, in fact, credit, and should be treated as such by both consumers and regulators alike.

Chairman BROWN. Mr. Seligman, are TRAPs, which lead the consumer in debt for their employment training, is that considered credit?

Mr. SELIGMAN. Yes, absolutely, and they should be covered by consumer protections. I will say that some employers may argue that the underlying training is not for the benefit of the employee, the personal benefit of the employee, and is in the benefit of the employer. But in those cases, again, the TRAP is a violation of minimum wage laws, and that is why it is so important that we have coordination between the Department of Labor and the CFPB on these issues.

Chairman BROWN. Thank you. As you both have said, these products are credit and relevant consumer protections, like TILA and the Military Lending Act and State usury caps should apply. I am glad, as you mentioned in your testimony, that CFPB, under the leadership of Director Chopra, has launched an inquiry on some of these products. It is acting like the consumer watchdog that that job was created to be.

Mr. Seligman, training the TRAPs, Training Repayment Agreement Provisions, raise the troubling prospect of an economy in which employers prey upon their workers' optimism to bind workers to their firms, turning debt into a tool for coercion, limiting economic mobility. You have discussed that.

My question is, by saddling workers with debt, limiting their freedom to move, or search for a job, do TRAPs limit worker mobility? If you would comment on that.

Mr. SELIGMAN. Absolutely, and, in fact, I think that is the purpose on the employer side. We often see that the debt at issue far exceeds the value of the training. In a recent case, for example, a

trucking company sought to collect \$6,500 from workers for whom it paid training costs that did not exceed \$2,500. So it is not an effort to recoup the reasonable cost of training but very obviously, on its face, an effort to trap workers.

Chairman BROWN. So how does limited worker mobility impact individual households? You have said what this means for employers. It obviously means limited mobility for employees. How does that impact individual households? How does that impact the broader economy?

Mr. SELIGMAN. Thank you. The costs of these types of arrangements, which indenture workers, can be devastating. We have spoken to workers who are trapped in abusive employment relationships, to workers who are not being paid a living wage, who are not being paid what they are owed. That can be incredibly traumatizing for workers.

Additionally, there are lots of data from the noncompete context which identify how these types of arrangements suppress wages. We know that they also interfere with the ability of competitors to hire workers that will increase productivity and be paid more and treated better.

Chairman BROWN. Expand on that a little bit more, how it threatens wages and salaries and then how it undermines future job opportunities. Walk that out a little for us.

Mr. SELIGMAN. Absolutely. One of the most important tools that any workers has in the employment relationship, core to their bargaining power, is the threat of exit, the threat of being able to go and work somewhere else. Employers understand this. In an effort to suppress wages, even as their profits grow, many employers have sought to artificially undermine worker mobility. And as a consequence, that traps workers in jobs in which they are not treated as well as they ought to be but also in a labor market in which they do not have the power to earn the wages they are owed.

Chairman BROWN. And you can see how these provisions, these actions, undermine the dignity of work and what that means for workers. As I said before, I look forward to seeing the results of CFPB's inquiry and how we move forward. CFPB is obviously looking at consumer protections but also antiworker practices.

Last question, Ms. Gittleman. Earlier this week, Briana Gordley from Texas testified that the Buy Now, Pay Later credit she took out was initially manageable until a variety of BNPL companies approved her for more than \$1,500 in credit combined. She was a college student at the time she took out those loans. Does that sort of underwriting meaningfully assess a borrower's ability to repay? For example, do these companies assess whether a consumer has multiple BNPL loans with different providers?

Ms. GITTLEMAN. No. Most providers do not meaningfully assess a consumer's ability to repay. As it stands right now there is no way for companies to verify how many loans consumers have across different providers, and for many providers consumers need only provide a payment form, verify their identity, and do a soft credit check, which again does not meaningfully assess a consumer's ability to repay.

Chairman BROWN. Thank you. And considering that one-third of consumers who use BNPL missed one or more payments, and of

those consumers 72 percent reported a decline in their credit score, it seems that those underwriting standards need strengthening.

Senator Toomey.

Senator TOOMEY. Thank you, Mr. Chairman. Mr. Zywicki, you know, it seems to me that a lot of the innovations in fintech are designed, in many cases, to provide a service to people who seem to be mostly left out of existing financial products, or at least with respect to credit. And it is disruptive to the incumbent players but it creates whole new opportunities for these consumers.

So could you just share for us, what do you think is the best way to think about regulating? Take the BNPL, or, for that matter, the Earned Wage Access. How should we think about going about the regulation so that we do not stifle innovation of these products or the next generation that we have not thought of yet?

Mr. ZYWICKI. Thank you for that question which I think is the big question on the table here. And I first want to agree and associate myself with your observation which is that I think the great promise of fintech is with respect to traditionally underserved consumers, which is, again, the market works pretty well for middle-class consumers, upper middle-class consumers. We have plenty of options, high-quality options and the like.

But it has always been this problem of serving underserved consumers, and the real problem as always been the cost. It is very costly to make small loans. There are a lot of fixed costs involved in making loans. And fintech potentially unlocks that by providing low-cost options, slick, kind of transparent, competitive options that do not have a lot of overhead and the like.

And so what my big concern is, is taking regulations, regulatory structure that is very archaic, that really dates back to the 1970s, which is the world of sort of pen-and-paper, maybe early prototype computers, and trying to take that regulatory scheme, which is already pretty creaky around the edges and does not work very well and does not fit a lot of products very well, and trying to impose that on the new fintech economy I think could really be a problem, which is it is not really designed for that.

Bad regulation can have costs with very few offsetting benefits, and I think the real issue we should be focusing on is ensuring that we are protecting consumers, so sometimes that means we should be doing more aggressive enforcement and less reliance on information, promoting competition, promoting innovation and the like.

Senator TOOMEY. And just to be clear, so are you aware of data that suggests that the consumers who actually use BNPL facilities tend to be younger, lower income, maybe have a history of credit problems? Are they, in fact, the people who have a more difficult time obtaining credit?

Mr. ZYWICKI. Absolutely. They seem to be the people relying on it the most. There are some middle-class people who are kind of doing it as a gimmick, I think. But really the value proposition here is for lower-income, younger, traditionally excluded consumers.

Senator TOOMEY. OK. So then it becomes important that these consumers understand what it is they are getting themselves into. That is certainly important.

Ms. Lee, are you aware of evidence regarding whether or not consumers actually understand the terms of the transaction? I am referring specifically to BNPL products.

Ms. LEE. There have been two different studies recently, one from the Financial Health Network which said 99 percent of the consumers who use BNPL products understood the terms and conditions. And recently, just this last weekend, Morning Consult did a survey as well and they found that 94 percent of the consumers that used BNPL products understood the terms and conditions. I think that is a very high mark of people that really understand what these products are about, what their obligations are, and have full understanding of the terms.

Senator TOOMEY. So I know there are some people who are concerned that these BNPL companies take advantage of consumers, but let us think about the transaction here. First of all, typically it is zero cost, there is no interest rate paid, the fee that is paid and the income to the BNPL company typically comes from the merchant, who has plenty of incentives to pay that fee.

So I guess the risk to a consumer would be if you do not make a payment on time you could get hit with a late fee. So what do we know about how prevalent late fees are, how many consumers are hit with them, how big a percentage of BNPL companies' incomes derives from late fees?

Ms. LEE. A couple of different things I will try to unpack there. As far as on the late fees, what we know from, in general, the industry standard, less than 4 percent actually incur a late fee.

Senator TOOMEY. Less than 4 percent of consumers.

Ms. LEE. Less than 4 percent of consumers using a BNPL product incur a late fee. So 90 percent of those using do not incur. They pay on time, and they are able to manage and fit their budget accordingly. And so that is why you are seeing the increased use of these is because it is allowing them to fit their budgets.

As far as on the derision of how much of the companies derive their revenue from that, around 85 to 87 percent of companies derive from merchant fees. There are other fees put into there, either a late fee or otherwise, but 85 to 87 percent of a BNPL company comes from merchant fees.

Senator TOOMEY. Thank you very much. Thank you, Mr. Chairman.

Chairman BROWN. Senator Warren, from Massachusetts, is recognized.

Senator WARREN. Thank you, Mr. Chairman. So last month, President Biden made the historic decision to cancel up to \$20,000 in student loan debt, and this is going to deliver life-changing relief for as many as 43 million middle-class, working-class Americans. It is going to be nurses and truck drivers, nail technicians, and millions of people who were not able to finish their degrees.

So while families are breathing a sigh of relief, corporations that made billions of dollars off a broken student loan system are now busily laying new traps in a shameless, last-ditch effort to try to line their pockets.

Navient, one of the world's largest and worst loan servicers, is now leading the way. According to reports, immediately after the cancellation was announced Navient sent multiple emails to bor-

rowers encouraging them to refinance their Federal loans under Navient's private lender, NaviRefi, with the promise of lower interest rates.

Ms. Gittleman, your organization has a long history of protecting consumers from student debt scams so I want to ask you. Let us say a borrower decides to take Navient up on their offer and refinances their Federal loans with a NaviRefi tomorrow. What would this mean for cancellation under President Biden's plan?

Ms. GITTLEMAN. Thank you, Senator Warren, for the question. If they refinance with NaviRefi then they will essentially be replacing their Federal student loans with a private student loan. Because only Federal student loans are eligible for cancellation, that means they may no longer be eligible for that cancellation. That is a huge loss for borrowers eligible for cancellation, but Navient only mentioned this in the fine print at the bottom of those emails.

Senator WARREN. So they could be forfeiting \$10,000 to \$20,000 worth of debt cancellations. In other words, right after the President announced student loan cancellation, Navient sent out notices to people who could be eligible, encouraging them to refinance so they would not be eligible for debt cancellation.

We do not know at this point exactly which borrowers Navient sent these emails to, although I have sent a letter asking for more information from Navient. But it appears that instead of sending borrowers information to help them get the cancellation that they may be entitled to, Navient pushed borrowers toward loans that could, at best, complicate their ability to get cancellation.

Ms. Gittleman, does Navient make more or less money if its borrowers get their loans canceled?

Ms. GITTLEMAN. The future of Navient's lending business depends on its ability to take the most creditworthy people, with Federal student loans and refinance them into private loans. Every borrower who is debt-free as a result of President Biden's action is one fewer prospective customer for Navient.

More broadly, the better the deal the Federal Government offers borrowers with Federal student loans, the less opportunity Navient has to sell people its private loans.

Senator WARREN. So I just want to underscore what you just said. Every borrower who is debt-free is one less borrower for Navient to profit from. I think that was a fair summary. Is that right? So no wonder Navient is trying to steer borrowers away from cancellation.

Look, this is outrageous behavior, and it is why I sent letters to Navient and to other loan servicers yesterday, asking them what steps they are taking to ensure that consumers receive timely and accurate information about their loans and their eligibility for cancellation.

By the way, this is not the first time that Navient has been caught trying to take advantage of borrowers. Between 2009 and 2019, there were at least 10 incidents where Navient, or its corporate predecessor, Sallie Mae, was accused of or fined by Federal and State regulators for actions that ripped off borrowers, including steering borrowers to repayment options that actually made it harder for them to pay back their loans, failing to report borrowers complaints, and harming disabled veterans' credit reports.

Policymakers need to keep a close eye on servicers to ensure that borrowers are protected as they await debt cancellation, and I am going to continue fighting to make sure that happens.

Thank you, Mr. Chairman.

Chairman BROWN. Thank you, Senator Warren.

Senator Warner, from Virginia, is recognized.

Senator WARNER. Thank you, Mr. Chairman, and I appreciate you holding this hearing. I think back. You know, I have been on the Committee for a long time now, and when we used to look at the nonbank sector we thought about it in the commercial sense, you know, asset-backed securities, CDOs, repos, and there were some benefits there. But then what we saw in the financial crisis they were also the source of a lot of economic meltdowns.

We have seen since the financial crisis, and that is one of the reasons why I appreciate you holding this hearing, is that we have seen now a migration in the nonregulated part of the financial industry a massive amount of new consumer products come up in this area. As a matter of fact, banks' share of mortgage originations fell from 91 percent to 32 percent. The share of small business loans and unsecured loans dropped by 10 percent from the regulated industries. And we have seen this in a whole host of new areas.

We have spent some time, and I think I have still got to get more education on issues like crypto, but we have seen specialized fintechs, peer-to-peer networks, frankly some of the big tech firms getting into the payment space, and some of these things bring real benefits. But I think we focus sometimes on almost exclusively the benefits and not on some of the challenges.

The truth is I think there are reasons that we have regulated financial institutions, and with that regulation while there are burdens there also comes, I think, some benefits.

I want to start again with you, Ms. Gittleman. Your testimony states that new products are "exploding across consumer markets." How should we keep an eye on these new products, recognizing a lot of consumers like them, do not care whether it comes from regulated entities or nonregulated entities. But my concern is how do we make sure that we are guarding the protections for the consumers in this nonregulated banking sector?

Ms. GITTLEMAN. Thank you for the question, Senator Warner. You know, we have Federal and State regulators, and regulation and oversight of markets benefits everyone. There is more competition. Regulated entities have a clear expectation of what is allowed and what is permitted. And consumers benefit from being protected and knowing that they are protected.

We have appreciated the CFPB's inquiry into BNPL providers, and we look forward to seeing what research they found. But we would also encourage them to supervise the fintech lenders that we are talking about today, under various different authorities and that are in my written testimony. But we would encourage them to supervise each of these industries so that consumers are protected and that the regulated entities have a very clear sense of what is permitted.

Senator WARNER. I know I was a big advocate a number of years back of more experimentation in the fintech sector, and I know

there was probably some disagreement even on my side of the aisle about when OCC was talking about kind of voluntary charters, and some critique that that would be almost regulation lite. I personally think we maybe ought to revisit that because at least it sweeps some of these entities into some regulatory structure.

I fear that the kind of, whether it be CFPB or this hodgepodge of State regulations, does not give the clarity that we need. And I would like, basically, the rest of the panel to address, from your organization's standpoint, with the proliferation of these new products—and again, consumers probably not caring at the end of the day whether it is a fintech, a bank, a credit union. They just want to get the product. But how do we make sure that we put some framework around this.

Very nice to see you, Ms. Lee, in your new role, and I would love to hear from the rest of the panel on that subject.

Ms. LEE. Good to see you, Senator. And on that subject I would say that there is, you know, with the products that we are talking about today, in particular but larger, there are three different ways. One is to enter into State agreements with money transfer licenses, and that would put them in, once they are licensed and they are also under examination for the abilities of which they do, which is on the money transfer.

They can enter into bank fintech partnership. When they enter into bank fintech partnerships they are subject to the oversight of the State and Federal banking system, overdraft and other things, and to ensure the fairness, safety, and soundness.

And then third, to your point, they can go pursue their own charter, their own banking charter, whether that be through the OCC, through an ILC, or through other means. I would say many of our member companies seek that. Unfortunately, there has not necessarily been a moratorium but there has been a very slow acceptance of having special purpose or other types of national bank charters. Many fintech companies are asking to be in the more regulated space to be able to fit the purpose of what they are trying to accomplish. We would welcome the opportunity for the various different regulatory bodies to be able to approve those so that you can have a fullness and understanding of what these partnerships look like.

Senator WARNER. If the other panel members could quickly address that.

Mr. ZYWICKI. Thank you. I will be brief. Thank you for that question. I agree. It is a big problem, the hodgepodge of State regulations when it comes to fintech. Fintech only really works on a national basis, to make the economics work.

As the chairman of the CFPB Task Force, I think somewhat controversially, we recommended that the CFPB be given chartering authority for nonbank financial services institutions. I believe the OCC fintech charter could work. I also fear that if the OCC is in charge that the big banks will co-op the process to impose unnecessary burdens on them.

And so I would suggest considering something like the CFPB be given the authority to charter nondepository consumer financial providers.

Senator WARNER. Mr. Seligman.

Mr. SELIGMAN. Thank you, Senator. You asked what frameworks apply, and I would suggest that in most cases we have the frameworks. These products are credit, as Ms. Gittleman testified to, and we should not allow the fact that they are dressed up in fintech terms or sometimes bound up with the employment relationship to alter our perspective on that critical point.

Senator WARNER. I know my time has expired, Mr. Chairman, I have also been looking at the question. There are a lot of ancillary products that are kind of sold into the regulatory industry, and there is actually an affiliation of regulators that look at how those products are sold in. That might be an area I need to learn a lot more about, but it might be another framework.

Because we are talking about consumer protections here, we can make the same kind of question about cyber protections in this area, and the idea of this whole sector going without any framework of oversight, I frankly do not think the hodgepodge State regulatory system is going to meet the mark. But I appreciate you holding the hearing.

Chairman BROWN. Thank you, and thanks always for your insight, Senator Warner.

Senator Reed, from Rhode Island, is recognized.

Senator REED. Thank you very much, Mr. Chairman, and thank you to the panel.

Ms. Gittleman, I have introduced S. 2508, the Veterans and Consumers Fair Credit Act, with Chairman Brown and several members of the Committee, and this legislation would establish a nationwide interest rate cap of 36 percent, with the goal of eliminating predatory loans from our consumer credit markets. We already have something similar to this with the Military Lending Act, where we are protecting our service men and women with this same limit.

Can you give us some examples of the new, emerging products that appear to be consumer-friendly but in practice are predatory and really exceed 36 percent?

Ms. GITTLEMAN. Thank you, Senator Reed, for this question and for your advocacy on the Veterans and Consumers Fair Credit Act, and Chairman Brown as well.

Finance products that use the tip model are an example of this. Pricing can look very affordable on the outset but can reach as high as traditional payday loans.

Other loans that we have not necessarily talked about today but I addressed in my written testimony that are offered online or through a smartphone application and especially those that use the rent-a-bank scheme to peddle high-interest loans, even in States where those rates are illegal.

Senator REED. You mentioned the rent-a-bank arrangements, can you describe how they avoid the State usury limits?

Ms. GITTLEMAN. Sure. Banks are largely exempt from State interest rate caps, and high-cost lenders have used this exemption to launder their loans through banks in order to evade State interest rate laws. This is not a true bank partnership like Ranking Member Toomey was speaking about. The high-cost lender has the predominant economic interest in the loan. They are doing the majority of the underwriting, reaping the majority of the benefit, taking

on the majority of the risk. And they either name the bank at the very end of the agreement or they pass the loan through the bank in order to evade that State interest rate cap.

Last year, Congress, in the bipartisan rebuke, rebuked these partnerships, these rent-a-bank schemes, but the Veterans and Consumers Fair Credit Act would protect consumers from these high-interest loans that are evading State interest rate caps.

Senator REED. There is another product that is becoming more prominent. That is the Buy Now, Pay Later. These loans allow consumers to split payments for products like electronics and clothing into four equal installments, typically, that are due every 2 weeks. They have been very, very popular in the pandemic. In fact, according to the Mercator Advisory Group, \$55 billion in Buy Now, Pay Later credit was extended in the last year in the United States, and they are projected an expansion more \$100 billion by 2024.

Which consumer protections laws apply to Buy Now, Pay Later loans and which do not?

Ms. GITTLEMAN. We would argue that most consumer protection laws should apply to Buy Now, Pay Later. As it is being structured more and more like open-end credit, TELA should apply with finance charges and mandatory arbitration agreements. Military Lending Act should apply. As it is commonly used by consumers of color, ECOA, the Equal Credit Opportunity Act should apply.

Since many products require or include authorization for payments to be automatically deducted, the Electronic Funds Transfer Act should apply. For products that allow consumers to consent to debt collection in the initial terms and agreement, the Fair Debt Collection Practices Act should apply. And finally, Federal regulators should supervise Buy Now, Pay Later providers and ensure that they are not engaging in unfair, deceptive, or abusive acts and practices or unlawful discrimination.

Senator REED. It is also my understanding that the BNPL lenders do not report to the credit bureaus in any standardized fashion, which complicates evaluating the credit of an individual for other types of loans. Is that accurate?

Ms. GITTLEMAN. So we are in the beginning processes of having that Buy Now, Pay Later data incorporated into credit reports. It is not done in a standardized manner. Each of the credit reporting bureaus have their own format of incorporating and using that data. And it might both not only have underwriting consequences but also credit reporting and credit scoring consequences as well. FICO scores of credit reports that have incorporated said data have lowered slightly, and it just illustrates that, at best, the current credit reporting system is an awkward fit for Buy Now, Pay Later.

It is not traditionally what fits into the credit reporting system. So this needs to be done thoughtfully to ensure that consumers are protected.

Senator REED. Well, thank you very much. Thank you, Mr. Chairman.

Chairman BROWN. Thank you, Senator Reed.

Senator Van Hollen is recognized, from Maryland. He is recognized from his office, I believe.

Senator Cortez Masto, of Nevada, is recognized from her office.

Senator CORTEZ MASTO. Thank you, Mr. Chairman. Thank you to the panel members for helping to facilitate this conversation. And by the way, if some of my colleagues do not remember, I do, in 2007, when there were new financial products that were offered by Wall Street called mortgage-backed securities. And then they were followed by other financial products—teaser rates, adjustable-rate mortgages, interest-only loans to borrowers—that led to the subprime mortgage meltdown that caused a recession starting in 2007. So I do think it is appropriate for us to be having this conversation today, and so appreciate the panelists here for their comments so far.

Mr. Seligman, let me start with you. I have done some work around franchises, and I have been long concerned about unfair practice related to some franchise businesses. I do not know if you have seen but I issued a report in 2021 called “Strategies to Improve the Franchise Model, Preventing Unfair and Deceptive Practices.”

Now let me just say, there are some models that are just very good business models, but as always there are some predatory-modeled predators within the system, and those are the ones I am highlighting.

So Mr. Seligman, let me ask you this. How can the promise of an independent franchise sometimes become a way to trap workers in jobs with low wages and crushing debt?

Mr. SELIGMAN. Thank you, Senator, and first let me say I appreciate your work in this space, standing up for small businesses and for workers. Very often we see the predatory franchise opportunities target those who have been left behind by our labor market, who are excluded from some of our most hard-fought labor protections, disproportionately immigrants and people of color. Predatory companies can go to them and they can say, “Look, the traditional employment opportunities have not provided you with a path to financial success, and so instead let me sell you on a purported entrepreneurial opportunity, the opportunity to own a small business, to become a franchisee.” Instead, these companies will trap workers in arrangements where the companies exert extraordinary control, where the workers do not have the ability to set their own prices or even sometimes communicate directly with their clients. And instead of being paid wages, the predatory companies will often say, “You owe us a franchise fee. And because those franchise fees can be so high, we are going to finance those fees for you. We are going to loan you the money to pay for the upfront costs.” This can create a really vicious cycle of predatory debt and effectively involuntary servitude.

Senator CORTEZ MASTO. Well, thank you, and I appreciate your comments because it is an area where I would hope my colleagues would join me. I have some legislation to help us level that playing field and just get more information out to potential franchisees, so thank you. Let me jump to Training Repayment Agreement Provisions and how it is impacting nursing. The U.S. Bureau of Labor Statistics reported that we need more than 179,000 nurses to meet our national shortage, and many reasons contribute to the shortage. However, I was shocked to see the prevalence of the Training Repayment Agreement Provisions among nurses with repayments

as high as \$20,000. So Ms. Gittleman, can you expand on the use of TRAPs in the health care profession?

Ms. GITTLEMAN. Sure. Thank you for the question, Senator. You know, these TRAPs are becoming more and more prevalent across different industries. They are infiltrating trucking, nursing, PetSmart employees, social workers, and into our medical field as well. And this is a form of employee-driven debt that not only traps consumers in that debt but also hinders workplace mobility and exacerbates disparities.

Senator CORTEZ MASTO. Thank you. And Mr. Seligman, any other additional comments or things that we should be doing in Congress to address this, if anything?

Mr. SELIGMAN. Thank you. Yes, I just want to emphasize that in many of these arrangements, especially when it comes to immigrant nurses, will see employers justify extraordinary debts and training repayment agreements by saying that the worker entered into them voluntarily in order to have their visa sponsored. Of course, it is a fundamental tenet of our laws in this country that you cannot sell yourself into indentured servitude. I think it is really important that we attack these practices as being unfair and illegal. And I will also say, of course, in this area as in so many others, forced arbitration is at the root of the problem. So many workers are trapped and their rights are violated. Even if, as I said, no court would ever enforce the provision that is trapping them in their jobs or purporting to authorize debt collection, they cannot do anything about that because a forced arbitration provision prevents them from going to court, may require them to arbitrate in a far-off forum, or pay the other side extraordinary costs.

Senator CORTEZ MASTO. Thank you. I know my time is up, Mr. Chairman, but thank you. And I could not agree more about these arbitration agreements that are part of these confusing contracts. The consumer has no choice, does not get to negotiate these contracts, and that is why the arbitration clauses are so detrimental.

Thank you, Mr. Chairman. I appreciate it.

Chairman BROWN. Thank you, Senator Cortez Masto, and thank you for your reference to what happened a dozen or so years ago.

Thanks to the witnesses. I would like to submit for the record the testimony of BreAnn Scalley of California, whose former employer made her sign a TRAP, putting her in debt for \$5,500 to the employer after she resigned due to poor working conditions.

I would also like to submit for the record the testimonies last week—I had said earlier this—last week of Briana Gordley and Cassie Pennings, their stories describing their struggles with employer-driven debt and new credit products is important context to what it means to be a worker living with debt.

For Senators who wish to submit questions for the record, those questions are due Tuesday, September 20th. Each of you on the panel, if you would, have 45 days, please, to respond.

The hearing is adjourned. Thank you for joining us.

[Whereupon, at 11:24 a.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF CHAIRMAN SHERROD BROWN

Hard work should pay off for everyone.

That's the American dream.

That's what the dignity of work is all about—it's a concept that Pope Leo XIII spoke of in the 19th century, and popularized by Dr. King.

And when work has dignity, you can support yourself, your family, and your future.

But we all know what's happened over the last four decades.

Corporate profits have gone up. The stock market has soared. Executive compensation has exploded.

But wages have not kept up with the cost of living. Millions of workers with full-time jobs who aspire to the middle class can't join it, no matter how hard they work. And even people we may define as middle class don't feel much security and stability.

And when workers are forced to find ways to make up for the gap between what they're paid and what they should earn, what are they left with?

Debt.

Sometimes people will have to borrow money. Products that are well-designed, transparent, and regulated can help workers pay off an unexpected car repair, or help with the grocery bill, or cover a medical expense.

But as we heard at our listening session with workers last week, too often these products aren't well designed, they're rarely transparent, and they're not well-regulated.

For too many workers, the only credit products available lead to more debt and more financial instability.

We've discussed in this Committee the impact predatory payday lenders have on working families.

Today, we examine the impact some newer consumer financial products have on workers.

Companies tell us these new products are innovative, they're easy to use, they'll give people more options.

But so often, "innovation" is just a new way for companies to make money—while trapping people in debt.

Newer credit products, like "buy now, pay later," could help consumers pay for products in installments, with strong consumer protections.

Yet many of these products come with hidden fees, they lack transparency, and they aren't underwritten properly. Ads encourage consumers to use these plans for multiple purchases, at multiple online stores—racking up debt they cannot afford to repay.

Consumers like Briana Gordley.

As a college student, Briana started off with one of these loans. First one BNPL company, then two, then three. One company told her they were raising her credit limit from \$100 to \$1,000.

Initially, 18-year-old Briana wasn't too concerned. As she put it, if the companies "believed in my ability to repay my debt, then I did too."

With the approval of more and more credit, Briana was juggling \$1,500 in loans with different payment dates throughout the month, and her account kept getting overdrawn.

Briana's story gets to the core of the problem. With little to no underwriting, the "Buy Now, Pay Later" companies don't know if they're the only ones a consumer has credit with. And without proper term disclosures, a consumer is left in the dark.

For this model to work for consumers, we need real rules companies must follow, and proper disclosures.

Then there are new consumer products that use a so-called "tip model"—structuring themselves to deliberately avoid disclosing their terms, specifically avoiding important disclosures required by the Truth in Lending Act.

Products like cash advances, overdraft coverage, and Earned Wage Advances—that are not offered in conjunction with employers—use a model where consumers are asked to pay a "tip" to the lender, instead of a fee or interest rate to use the products.

Companies claim that because a tip is not presented as a finance charge or interest rate, Truth in Lending and other consumer protection laws, like the Military Lending Act, do not apply.

The tip is just "voluntary," they say.

But these tips are not voluntary at all.

It's just a way to cheat the system and hide the true cost to workers.

Employer-based Earned Wage Advances with strong consumer protections can help workers cover unexpected expenses or emergencies—though the better alternative would simply be for the companies to pay their workers enough to live on. And then there are debt products that are so predatory, so offensive, they should have no place in our financial system—schemes like Training Repayment Agreement Provisions, appropriately known as “TRAPs.”

I’ll say this for that term—it’s truth in advertising.

These provisions in employment contracts allow employers to recoup the cost of training employees who leave the job.

It’s an offensive concept.

It’s the employer’s job to train their workers. On-the-job training isn’t some special perk for workers—it’s a smart investment for companies.

TRAPs require workers to pay back their employers for training if they leave their job within a certain period of time, saddling workers with debt.

It’s just a modern day version of the scrip that left coal miners exhausted, destitute, and trapped by their employers.

Remember what Tennessee Ernie Ford sang about owing his soul to the company store: “You load 16 tons, what do you get? Another day older and deeper in debt.”

Employers use TRAPs to prevent workers from pursuing higher paying or better opportunities. They decide how much the training would supposedly cost on the market and go after their workers—threatening their credit and economic mobility.

Last week, Cassie Pennings from Colorado told Members of the Committee about her experience with TRAPs.

Ms. Pennings pursued her calling as a nurse during the COVID–19 pandemic.

At the start of her job, her employer made Ms. Pennings sign an employment contract, and buried in the fine print, it said that if she left before 2 years, she would be indebted to her employer for \$7,500 for the supposed training they provided.

When Ms. Pennings decided to leave her nursing job after a year because of a bad work environment, her employer took \$1,000 out of her second to last paycheck to payback her “training.” That was half of her paycheck.

Her former employer told her they will send the rest of the amount to collections.

Last I checked, indentured servitude was illegal in the United States.

But it looks like some enterprising companies are rebranding it, with these new employment contracts.

And that is the focus of today’s hearing: to ensure that so-called “innovation” is not a substitute for good pay and does not come at the cost of workers’ dignity of work.

PREPARED STATEMENT OF SENATOR PATRICK J. TOOMEY

Thank you, Mr. Chairman.

Today’s hearing is about new consumer financial products. In the last decade, we’ve seen financial institutions develop technology-oriented solutions to meet consumer needs. These new choices create a more competitive marketplace—all to the benefit of consumers.

As long as consumers have truthful and accurate information about financial products, they’re best positioned to decide what products to use. Any regulation of financial products should fit the product type, make room for innovation, and maximize consumer choice. Too often, however, the response from my friends on the other side of the aisle is to see something new and panic.

Some newer financial products offer consumers more options for short-term funding. One of them is called Buy Now, Pay Later, or BNPL. BNPL typically allows consumers to make purchases now, often online, and repay them in four interest-free installments later.

This service can be an attractive way for consumers to manage their cash flows to obtain goods and services without having to pay interest. That’s especially true for consumers who don’t have or don’t want to use a credit card for such purchases. This may explain why BNPL is most popular among younger consumers, who have shorter credit histories. If customers are late with payments, BNPL companies sensibly suspend further purchases until they are paid, and some charge a late fee.

Interestingly, BNPL companies do not primarily make their money from consumers, but rather from retailers, who pay them a small percentage of transactions to offer the service to customers. Retailers are willing to do this because they don’t have to pay credit card interchange fees on BNPL payments and offering BNPL can increase sales and customer loyalty.

Another newer financial product that provides consumers with short-term funding is Earned Wage Access, or EWA. This service can be an appealing alternative to payday loans for workers who want an advance on their wages.

Many people don't have savings available to pay for unexpected expenses that can arise in between pay periods, like car repairs or medical bills. EWA can help consumers to meet such expenses and others by advancing them the amount of income they've already earned at that point in the pay period.

There are various EWA products available. In some cases, employers select and pay the fee for the service as an employee benefit, while in others, consumers must pay the fee.

According to a recent study, the average fee a user paid per advance was \$2.59 to \$6.27. That's less than 5 percent of the amount advanced.

In short, marketplace competition has successfully generated more and cheaper options for many consumers to meet their needs. This is a reminder that market competition is typically better at helping consumers than the Government—whether the product or service is in the financial sector or another category.

Other newer financial products include forms of credit that have existed for a long time, but with innovations in how they're provided. In recent years, financial institutions—primarily community banks—have begun to partner with financial technology companies, or fintechs, to offer improved products and reach more consumers.

Bank-fintech partners offer a large variety of credit products, including small-dollar, personal, auto, and small business loans, as well as credit cards, mortgages, and home equity credit lines. These partnerships can generate significant consumer benefits by lowering the price of financial products, expanding consumer choice, and increasing competition. Often, they provide access to credit for higher-risk borrowers, such as consumers with lower-incomes or no credit histories, all through a highly supervised financial institution.

Unfortunately, some bureaucrats and lawmakers react with hostility to any new financial products. Democrats in Congress have pejoratively branded all bank-fintech partnerships as “rent-a-bank” schemes.

Last year, they overturned an OCC rule that provided regulatory certainty for these partnerships. Unfortunately, by attacking legitimate bank-fintech partnerships, Democrats risk restricting access to needed credit for lower-income consumers.

And the CFPB, under Director Chopra, has repeatedly demonstrated hostility to innovation in consumer finance markets. For example, he's replaced the CFPB's Office of Innovation with a new “Office of Competition and Innovation” to advance his efforts to involve the CFPB in antitrust and competition law, which is outside its jurisdiction. He also sidelined the Office of Innovation's programs to foster responsible innovation, such as no action letters and regulatory “sandboxes.”

I'm also concerned the CFPB will bring this reactive, anti-innovation perspective to its scrutiny of new financial products. Already, it's made public statements that suggest hostility towards BNPL and other products.

All of this hostility to new financial products is further evidence of the condescension and paternalism of some of my colleagues to our constituents. Individual consumers are better positioned than any bureaucrat or politician to understand their own individual needs and preferences, and make their own choices. My colleagues ignore the benefits consumers derive from access to more choices in a more dynamic marketplace.

The best form of consumer protection is a robust, competitive market. That's why, instead of curtailing new financial products, regulation should facilitate innovation and consumer choice.

PREPARED STATEMENT OF RACHEL GITTLEMAN
FINANCIAL SERVICES OUTREACH MANAGER, CONSUMER FEDERATION OF AMERICA
SEPTEMBER 13, 2022



Consumer Federation of America

Testimony of
Rachel Gittleman, Financial Services Outreach Manager
Consumer Federation of America
Before the
U.S. Senate Committee on Banking, Housing, and Urban Affairs
Full Committee Hearing: “New Consumer Financial Products and the Impacts to Workers”

September 13, 2022

The Consumer Federation of America (CFA) greatly appreciates the opportunity to testify before the Senate Committee on Banking, Housing, and Urban Affairs on “New Consumer Financial Products and the Impacts to Workers.” CFA is a nonprofit association of more than 250 national, state, and local consumer groups that was founded in 1968 to advance the consumer interest through research, advocacy, and education. For over 50 years, CFA has been at the forefront of ensuring that our marketplace is fair and safe through advancing the consumer interest. CFA has a broad portfolio of issues including financial services, banking, credit, investor protections, privacy, food safety, product safety, telecommunications, energy efficiency, housing, insurance, and saving. CFA’s non-profit members range from large organizations, such as Consumer Reports and AARP, to small state and local advocacy groups, as well as unions, co-ops, and public power companies.

New consumer credit products are exploding across market areas, including but not limited to Buy Now, Pay Later (BNPL) and Earned Wage Advance (EWA) products. Fintech providers are using the guise of innovation to offer “free” cash advance and overdraft protection products in exchange for purportedly voluntary tips. Predatory lenders are finding rogue banks to launder their loans through in order to evade state usury and consumer protection laws. Plus, Training Repayment Agreement Provisions (TRAPs) trap consumers in low paying jobs with the threat of unmanageable debt and high interest rates.

Although these products, provisions, and fee models seem incredibly different at first glance, and are unique in reality, they share one thing in common: they disguise credit and its true cost to consumers and regulators alike.

Some of the fee models, schemes, and provisions discussed today are inherently deceitful and downright predatory. Other products may help certain consumers manage their finances, but even those are not risk free. Either way, at their core, each of the products and provisions discussed today are still credit products that should be covered by basic consumer protections at the state and federal level, including interest rate limits, underwriting for ability-to-repay, cost transparency, dispute rights, and fair lending laws.

The consumer credit products discussed during this hearing are each distinct, however they share similarities in how they operate and how they use “innovation,” whether in how the product is

offered (via smartphone application/online), labeled, or structured, to claim that they do not fit within the existing regulatory framework. Regardless of their structure, each of these products is credit—they provide funding or the promise of funding today and are repaid at a later date. Given that, these products should be subject to the host of state and federal consumer protection laws that regulate credit products and prevent discrimination. It is also important that they be examined for unfair, deceptive, or abusive practices independently of compliance with credit laws.

Although innovation has an important role in the financial marketplace, it should be pursued in a way that is consistent with and enhances consumer protections. It should not shield innovators from enforcement and supervision nor limit state and federal regulatory authority.

This testimony will address various emerging forms of credit: Buy Now, Pay Later; Earned Wage Advance; cash advance, overdraft protection, and other credit products that collect “tips; Training Repayment Agreement Provisions; and Rent-a-Bank loans.

Buy Now, Pay Later products, if used as designed, can provide consumers with an affordable way to finance larger purchases, as these products allow consumers to purchase an item by only paying a portion of the price up front. Then, the consumer typically pays the rest of the credit in three equal, often interest-free installments over a set period (often 6 weeks). However, depending on structure, BNPL products can lack underwriting for a consumer’s ability to repay, can rely on the expectation of fees, can lead consumers into taking on unmanageable amounts of debt, can lack dispute or refund rights should a consumer be unsatisfied with their purchase, and can lead to negative credit reporting and debt collection.

Earned Wage Advance (EWA) products are funds advanced by a third-party to a consumer before the consumer’s regular payday. These funds are repaid out of the next paycheck. EWA products that charge fees are ostensibly a lower-cost form of a payday loan—requiring workers to pay to get paid—and should be regulated as credit. Many employers are starting to offer EWA programs for free, making those fee-based programs even more concerning. These programs are not risk free, as they can lead to the same cycle of repeat borrowing as other balloon payment loans. Even free EWA products may still create a hole in next week’s paycheck and should be studied further.

Faux Earned Wage Advance, overdraft protection, and other cash advance products that collect “tips” are simply disguising finance charges under a new name. Tips are not truly voluntary, as they can be structured so that it is difficult for the consumer to avoid paying the default tip. By labeling finance charges otherwise, consumers feel obligated to tip, like in a restaurant or service setting, but unlike those settings, tips for credit products do not go towards a worker but rather the company’s bottom line. The true cost is not clear to consumers, and tips can add up quickly, costing nearly as much as traditional payday loans in some instances. These should be viewed and regulated as finance charges subject to state and federal credit laws, including state usury laws and the Military Lending Act (MLA). Lenders that claim to provide consumers with EWAs but are not integrated with employers are simply payday loans and should be regulated as such.

Training Repayment Agreement Provisions (TRAPs) are a form of shadow student debt—employment contract provisions that require a consumer to pay large fees for on-the-job training or orientations if the consumer decides to leave before an arbitrarily determined date, essentially

indebting the consumer to the employer. TRAPs are often found buried deep within employee contracts for low-paying jobs with poor working conditions and are essentially used to trap the employee in the job with threats of high interest rates, attorney and collection fees to collect the money owed, or withholding of other benefits, like pay and retirement balances, should they leave before the predetermined date.

The "rent-a-bank" scheme is used by predatory, often payday lenders in order to charge triple digit interest rates in states where those rates are illegal. Banks are largely exempt from state interest rate caps, so the predatory lender finds a rogue bank to name on the loan agreement or launder the loan in order to evade state laws. Rent-a-bank loans can be payday, auto-title, or installment loans, as well as credit offered through businesses that sell auto repairs, furniture, and even pets at rates as high as 200% APR.

Each of these products should not use the guise of innovation, the cover of a lengthy employment contract, a borrowed label, or a sham bank partnership to shield themselves from federal and state oversight and regulation of credit, consumer protection, and fair lending laws. Oversight is especially urgent as these offerings continue to increase and infiltrate new market areas. Failure to do so would lead to an undermining of consumer protection laws, making the financial marketplace less fair and competitive.

CFA recommends the following:

- Innovative financing products should be viewed and regulated as credit. State and federal financial regulators should supervise fintech providers to ensure that they are compliant with federal and state credit, fair lending, and consumer protection laws, as well as not engaging in unlawful discrimination or unfair, deceptive, or abusive acts or practices.
- Fintech providers should only offer products after determining a consumer's ability to repay. Ability to repay should consider both income and financial obligations, as failure to do so can lead to a cycle of debt.
- Price transparency and unified terms and conditions are critical. The cost of credit should only be portrayed to consumers as an Annual Percentage Rate (APR) so that they are able to compare products and make informed, knowledgeable decisions based on their financial situation.
- Loans should be structured in an affordable way with proportional penalty fees, so that a consumer can repay without needing to reborrow or borrow elsewhere. Regulators should closely examine evasive pricing models including tips, inflated fees, participation fees, and payment rescheduling fees, to ensure that these are not evasive attempts to disguise finance charges.
- Consumer data should only be used in a responsible manner and in a way that consumers expect it to be used.
- State and federal regulators should consider collecting, analyzing, and publishing data to better understand and illuminate the risks associated with these products.
- State and federal regulators should work together, across agencies and levels of government, in order to ensure consumers are protected and predatory actors are held accountable.
- For BNPL, consumers should have the same chargeback rights as they do with credit cards, so that consumers have recourse should they run into a problem with their purchase.

- Congress should adopt a national interest rate cap, the simplest and most straightforward way to protect consumers from predatory interest rates.

1. Buy Now, Pay Later:

A. Introduction

Although Buy Now, Pay Later (BNPL) options only began to appear in 2019, these products and consumer use have increased dramatically in recent years. The market grew by more than 70% in 2021¹ and is expected to increase 10 to 15 times its current size by 2025.² Although BNPL use is still far less common than debit and credit card use, roughly one-third of adults have used BNPL in the last 12 months.³ BNPL is a checkout option available from many online retailers, credit cards, banks, and third-party providers that allows consumers to purchase an item by only paying a portion of the price up front. Then, the consumer typically pays the rest of the debt in three equal installments over a set period (often 6 weeks) and often without interest. BNPL credit accounts for a growing proportion of the non-bank credit market. For example, California found that the top six BNPL providers originated more than 10 million loans to consumers in 2020, which accounted for 91% of total non-bank consumer loans originated in 2020.⁴ Both the number of offerings and users of BNPL have continued to grow considerably in recent years.

A handful of companies are viewed as key players within the BNPL industry and have the largest market share of BNPL transactions in the United States— Affirm, Afterpay, Klarna, PayPal’s pay-in-4, Sezzle, and Zip, formerly known as Quadpay.⁵ Although BNPL products can help certain consumers manage their finances as discussed below, these products are not risk free.⁶ In

¹ Ron Shelvin, *Forbes*, “Buy Now, Pay Later: The ‘New’ Payments Trend Generating \$100 Billion In Sales” (Sept. 7, 2021), <https://www.forbes.com/sites/ronshelvin/2021/09/07/buy-now-pay-later-the-new-payments-trend-generating-100-billion-in-sales/?sh=71a2b7b62ffe> [hereinafter Shelvin, The “New” Payments Trend (Sept. 2021)].

² CB Insights, *Disrupting The \$8T Payment Card Business: The Outlook On ‘Buy Now, Pay Later’* (Mar. 2, 2021), <https://www.cbinsights.com/research/report/buy-now-pay-later-outlook/> [hereinafter CB Insights, *Disrupting* (Mar. 2021)].

³ Tom Akana, Federal Reserve Bank of Philadelphia, *Buy Now, Pay Later: Survey Evidence of Consumer Adoption and Attitudes* (June 2022), <https://www.philadelphiafed.org/-/media/frbp/assets/consumer-finance/discussion-papers/dp22-02.pdf> [hereinafter Akana, Federal Reserve Bank of Philadelphia, BNPL Survey Evidence (June 2022)].

⁴ California Department of Financial Protection and Innovation, *Annual Report of Finance Lenders, Brokers, and PACE Administrators Licensed Under the California Financing Law* (Oct. 2021), <https://dfpi.ca.gov/wp-content/uploads/sites/337/2021/10/2020-CFL-Aggregated-Annual-Report.pdf>.

⁵ BusinessWire, *United States Buy Now Pay Later Market Report 2022: BNPL Payments are Expected to Grow by 66.3% to Reach \$82086.8 Million in 2022 - Forecast to 2028 - ResearchAndMarkets.com* (Feb. 2022), <https://www.businesswire.com/news/home/20220214005569/en/United-States-Buy-Now-Pay-Later-Market-Report-2022-BNPL-Payments-are-Expected-to-Grow-by-66.5-to-Reach-82086.8-Million-in-2022---Forecast-to-2028---ResearchAndMarkets.com>.

⁶ See also, CB Insights, *Disrupting* (Mar. 2021).

⁷ For a sample of consumer complaints see Rachel Gittleman, *Statement for the Record Submitted to U.S. Committee on Financial Services’ Task Force on Financial Technology on ‘Buy Now, Pay More Later? Investigating Risks and Benefits of BNPL and Other Emerging Fintech Cash Flow Products’* (November 2, 2021), <https://consumerfed.org/wp-content/uploads/2021/11/CFA-Submits-Statement-for-the-Record-to-U.S.-House-Task-Force-11.2.21.pdf> [hereinafter Gittleman, *Statement re BNPL* (March 2022)].

⁸ See also, Ed Mierzwinski and Mike Litt, U.S. PIRG Education Fund, *The hidden costs of ‘Buy Now, Pay Later’ Complaints to CFPB show need for action* (March 2022), https://pirg.org/wp-content/uploads/2022/03/BNPL-REPORT-USPIRG_0.pdf [hereinafter Mierzwinski and Litt, U.S. PIRG, BNPL (Mar. 2022)].

addition, as BNPL expands into new markets, including auto repairs, medical care, groceries,⁷ and student loans,⁸ the risks posed by BNPL can be even more severe.

Further as compared to credit card users, BNPL users are more likely to earn less than \$75,000 annually, to be younger, and to be people of color.⁹ These consumers are more likely to have limited or no credit history, existing debt burdens, and less wealth and lower wages to pay off that debt. The consequences of unaffordable BNPL credit can be disproportionately severe for these consumers. And yet, BNPL products have largely evaded oversight by federal and state regulators.

While we greatly appreciate the Consumer Financial Protection Bureau's (CFPB) investigation into five of the largest companies offering BNPL in late December¹⁰ and the subsequent public inquiry, we are eager to see any resultant research and actions. In addition, we appreciate Senator Jack Reed, Chairman Sherrod Brown and other members of this committee urging the CFPB to take action regarding governance and oversight of BNPL providers.¹¹

However, to date, California is the only state that has taken enforcement actions against BNPL providers. California fined three BNPL providers in 2020¹² and an additional provider earlier this year¹³ for making unregulated loans to consumers and required them to apply for the applicable license.

⁷ Priya Krishna, *The New York Times*, "Would You Take Out a Loan to Buy This Week's Groceries?" (August 29, 2022), <https://www.nytimes.com/2022/08/29/dining/buy-now-pay-later-loans-groceries.html>.

⁸ Student Borrower Protection Center (SBPC), "Point of fail: How a Flood of 'Buy Now, Pay Later' Student Debt is Putting Millions at Risk" (March 2022), https://protectborrowers.org/wp-content/uploads/2022/03/SBPC_BNPL.pdf [hereinafter SBPC, Point of Fail (March 2022)].

⁹ Akana, Federal Reserve Bank of Philadelphia, BNPL Survey Evidence (June 2022).

¹⁰ Consumer Financial Protection Bureau (CFPB), "Consumer Financial Protection Bureau Opens Inquiry into 'Buy Now, Pay Later' Credit" (December 16, 2021), https://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-opens-inquiry-into-buy-now-pay-later-credit/?_gl=1*197krbo*_ga*MjI4MjE2NTIwLjE2MzY0MTA1NzY_*_ga_DBYJL30CHS*MTY2MjA2NjA2My44Ni4xLjE2NjIwNjYxMDIuMC4wLjA.

¹¹ U.S. Senate Committee on Banking, Housing, and Urban Affairs, "U.S. Senators Urge CFPB to Take Action to Ensure Transparency & Oversight of Buy Now Pay Later Products & Providers" (December 15, 2021), <https://www.banking.senate.gov/newsroom/majority/us-senators-urge-cfpb-to-take-action-to-ensure-transparency-and-oversight-of-buy-now-pay-later-products-providers>.

¹² California Department of Financial Services, "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/>.

California Department of Financial Services, "Point-of-Sale Lender Afterpay Agrees to Cease Illegal Loans, Pay Refunds in Settlement with the California Department of Business Oversight" (Mar. 16, 2020), <https://dfpi.ca.gov/2020/03/16/point-of-sale-lender-afterpay-agrees-to-cease-illegal-loans-pay-refunds-in-settlement-with-the-department-of-business-oversight/>.

California Department of Financial Services, "Point-of-Sale Lender QuadPay Agrees to Cease Illegal Loans, Pay Refunds in Settlement with the California Department of Business Oversight" (Apr. 22, 2020), <https://dfpi.ca.gov/2020/04/22/point-of-sale-lender-quadpay-agrees-to-cease-illegal-loans-pay-refunds-in-settlement-with-the-california-department-of-business-oversight/>.

¹³ CA.gov, "Buy Now, Pay Later Company Agrees to Cease Illegal Loans, Pay Refunds in Settlement" (August 9, 2022), <https://dfpi.ca.gov/2022/08/09/buy-now-pay-later-company-agrees-to-cease-illegal-loans-pay-refunds-in-settlement/>.

Other countries have seen similar growth in third-party BNPL products, and federal regulators have stepped in to protect consumers. For example, federal regulators in both Australia and the United Kingdom have recently taken steps to regulate BNPL apps.

The U.K. Treasury has said that BNPL providers are now under supervision of Britain's Finance Conduct Authority (FCA),¹⁴ and that the FCA would run affordability checks on BNPL providers and ensure that all marketing is fair and clear, among other measures.¹⁵ Additionally, Australian regulators created a new BNPL code of practice.¹⁶ It's time for federal and state regulators to provide much needed oversight of the BNPL industry.

B. Potential Consumer Benefits

These products may offer consumers an affordable alternative to finance large purchases. If used as intended, a consumer can finance a larger purchase without interest, only paying one quarter of the purchase price up front and then paying off the rest in three equal installments, typically over six weeks. A recent survey by Consumer Reports found that nearly half of those consumers who had used BNPL chose to do so because they "didn't have enough money to purchase what [they] wanted, so this enabled [them] to afford it."¹⁷ A Federal Reserve study also found that more than 46% of users opted for BNPL because of the size of the purchase.¹⁸ Although this illustrates that consumers may view BNPL as an alternative to finance large purchases, it also points to the likelihood that consumers are using BNPL for purchases outside of their budget.

In comparison to credit cards, some consumers view BNPL as a more affordable payment form that can be quicker to pay off. Indeed, of those who have used BNPL, more than half of consumers chose it instead of credit cards because they could pay back the purchase in installments rather than a lump sum.¹⁹ Similarly, another study found that nearly 44% of BNPL users chose it for the "ability to better manage their finances."²⁰ If paid back on time, BNPL credit can be interest free. For consumers carrying a revolving credit card balance, their purchases incur interest from the moment the purchase hits, which can cause credit card debt to be expensive and difficult to pay off. Further, credit card debt poses an increasing burden for many consumers, with credit card debt increasing to \$46 billion in the second quarter of 2022, marking the largest quarterly increase in the last two decades.²¹ If used as intended and with sufficient consumer protection, BNPL can certainly provide consumers with a more affordable

¹⁴ Ryan Browne, *CNBC*, "Britain is Cracking Down on the \$3.7 Billion 'Buy Now, Pay Later' Industry" (Feb. 2, 2021), <https://www.cnbc.com/2021/02/02/uk-to-regulate-buy-now-pay-later-bnpl-firms-like-klarna-and-clearpay.html>.

¹⁵ Elizabeth Piper and Huw Jones, *Reuters*, "Britain plans to regulate 'buy now, pay later' lenders" (June 20, 2022), <https://www.reuters.com/markets/europe/britain-introduces-plans-better-regulate-buy-now-pay-later-firms-2022-06-19/>.

¹⁶ *Finextra*, "Australian Finance Industry Association Introduces Voluntary Code of Practice for BNPL Sector" (Mar. 2, 2021), <https://www.finextra.com/pressarticle/86399/australian-finance-industry-association-introduces-voluntary-code-of-practice-for-bnpl-sector>.

¹⁷ Consumer Reports, *American Experiences Survey: A Nationally Representative Multi-Mode Survey* (Jan. 2022), https://article.images.consumerreports.org/prod/content/dam/surveys/Consumer_Reports_AES_January_2022 [hereinafter *Consumer Reports, American Experiences Survey* (Jan. 2022)].

¹⁸ Akana, Federal Reserve Bank of Philadelphia, *BNPL Survey Evidence* (June 2022).

¹⁹ Consumer Reports, *American Experiences Survey* (Jan. 2022).

²⁰ Akana, Federal Reserve Bank of Philadelphia, *BNPL Survey Evidence* (June 2022).

²¹ Jaclyn Peiser, *The Washington Post*, "Credit card debt surges as inflation pushes Americans to borrow more" (August 2, 2022), <https://www.washingtonpost.com/business/2022/08/02/credit-card-debt-inflation/>.

alternative to credit cards that can be paid off over a shorter period of time and in smaller installments than credit card debt.

Finally, some consumers may choose to use BNPL simply because it is convenient and easy, and increasingly offered at checkout for online purchases. Indeed, 20% of consumers who had used BNPL chose to do so because it was perceived as easier than paying with credit card.²² Some BNPL providers now offer a browser extension, making online purchases with BNPL even easier.²³ Of the top ten online retailers in the U.S., six either currently have BNPL options at checkout or have announced partnerships with BNPL providers.²⁴ The other four are available through third party applications.

C. Consumer Risks

As explained in our joint comments to the CFPB in response to the public inquiry regarding BNPL,²⁵ multiple parts of the BNPL business model and product can pose serious risks to consumers, including lack of underwriting; dispute and chargeback process; effect on credit report and score; potential debt collection; payment difficulty caused by a lack of consolidated statement and payment; and insufficient financial data privacy.

Marketing of these products is enticing, with promises of instant approval and no impact on a consumer's credit, however underwriting does not meaningfully assess a borrower's ability to repay. Underwriting for BNPL products varies based on provider, and many market "instant approval" or "no credit check required" for these credit products. For many providers, consumers need only verify their identity, provide a payment form, and have a "soft" credit check pulled.²⁶ Some BNPL providers base purchase approvals and spending limits on the number of purchases and on time payments made on that BNPL application, rather than holistically reviewing a consumer's ability to repay along with the rest of their financial obligations. One provider even said that they approve 90% of applicants, even if they can't find critical information about the person's history and another has said it does "no external credit checking."²⁷ Further, as we will address later, credit reporting varies by provider and by credit reporting bureau, so if consumers have multiple BNPL loans with various providers, there's currently no way for companies to assess that since most payment history is not reported to credit bureaus.

In addition, a recent Federal Reserve survey found that heavy BNPL users are most likely to cite a lack of credit or an inability to get approved for credit elsewhere as a reason for choosing

²² Consumer Reports, American Experiences Survey (Jan. 2022).

²³ Klarna and Zip now offer browser extensions for Google Chrome users, see <https://www.klarna.com/us/> and <https://zip.co/us/chrome> (last visited September 1, 2022).

²⁴ Jamie Grill-Goodman, *Retail Info Systems*, "Top 10 E-Commerce Retailers and Their Digital Experience" (Aug. 12, 2021), <https://risnews.com/top-10-e-commerce-retailers-and-their-digital-experience>.

²⁵ Center for Responsible Lending (CRL), Consumer Federation of America (CFA), & National Consumer Law Center (NCLC), Comment to CFPB re Notice and Request for Comment Regarding the CFPB's Inquiry into Buy-Now-Pay-Later (BNPL) Providers 87 FR 3511 Docket No.: CFPB-2022-0002 (March 25, 2022), <https://consumerfed.org/wp-content/uploads/2022/03/Joint-BNPL-comments-3.25.22.pdf> [Hereinafter CRL, CFA, NCLC, BNPL Comments (2022)].

²⁶ CFPB, "What is a Buy Now, Pay Later (BNPL) loan?" (December 2, 2021), <https://www.consumerfinance.gov/ask-cfpb/what-is-a-buy-now-pay-later-bnpl-loan-en-2119/>.

²⁷ Maxwell Strachan, *Vice*, "'I Know I Have an Issue': Does 'Buy Now, Pay Later' Convince People to Overspend?" (August 25, 2022), <https://www.vice.com/en/article/pkqkbg/i-know-i-have-an-issue-does-buy-now-pay-later-convince-people-to-overspend>.

BNPL.²⁸ Although we do not know whether heavy usage is caused or perpetuated by lack of sufficient underwriting, the correlation of high usage and citing lack of other credit sources as a reason for using BNPL is deeply concerning.

There are several trends that suggest that BNPL credit products are not meaningfully underwritten. For example, there is a high incidence of late fees and missed payments among BNPL users. Most providers charge late fees, and some charge other types of fees like missed payment fees, account reactivation fees, returned payment fees, and rescheduling fees. A 2021 survey of U.S. consumers who had used BNPL found that 38% had missed payments—and that percentage went up for younger consumers, with more than half of Generation Z or Millennials saying they had missed a payment.²⁹ For those who have fallen behind on payments, 72% reported a decline in their credit score.³⁰ A 2020 study found similar amounts of BNPL users falling behind on payments—43% of users had fallen behind on payments, and of those consumers, two-thirds said that the reason for falling behind was because they had lost track of payments.³¹ A U.K. study found that for some providers that charge fees, these fees can make up a significant portion of the company's revenue.³² Fees range depending on the provider, but can reach as high as \$25, and many providers lack limits on how many fees can be charged, causing fees to add up quickly.³³

Further, BNPL fees can trigger punitive overdraft and nonsufficient funds fees on the bank side. If a BNPL payment bounces or the consumer is late on a payment, late or returned payment fees can trigger overdraft and nonsufficient fund fees in a consumer's bank account. Thus, the consumer can be charged by both the BNPL provider and their bank. A Morning Consult survey found that one-third of BNPL users had overdrafted.³⁴ The survey also found that those consumers that had overdrawn their account were more than twice as likely as non-overdrafters to use BNPL.³⁵ It's unclear whether this overlap is because BNPL causes overdraft fees or because BNPL users are more likely to be struggling with their finances. Regardless, it illustrates that BNPL credit is being provided to those that cannot afford it. Overdraft and nonsufficient

²⁸ Akana, Federal Reserve Bank of Philadelphia, *BNPL Survey Evidence* (June 2022).

²⁹ Anna Ilerera, *Reuters*, "As 'Buy Now, Pay Later' Surges, a Third of U.S. Users Fall Behind on Payments" (Sept. 9, 2021), <https://www.reuters.com/technology/buy-now-pay-later-surges-third-us-users-fall-behind-payments-2021-09-09/>.

³⁰ *Id.* Although this study was released prior to the announcement that the credit reporting bureaus would begin incorporating BNPL credit into credit reports, it illustrates the fact that BNPL credit is an awkward fit, at best, within existing credit reporting system.

³¹ Penelope Wang, *Consumer Reports*, "The Hidden Risks of Buy-Now, Pay-Later Plans" (Feb. 14, 2021), <https://www.consumerreports.org/shopping-retail/hidden-risks-of-buy-now-pay-later-plans-a7495893275/> [hereinafter Wang, *Consumer Reports*, *Hidden Risks* (Feb. 2021)].

³² Personal Finances and Funds Team, U.K. HM Treasury, *Regulation of Buy-Now Pay-Later Consultation* (Oct. 2021), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1027366/210923_-_BNPL_condoc_-_Cleared.pdf.

³³ Leticia Miranda, *NBC News*, "The Hidden Costs of 'Buy Now, Pay Later' Loans" (Nov. 4, 2021), <https://www.nbcnews.com/business/consumer/hidden-costs-buy-now-pay-later-loans-rcna4367>.

³⁴ Claire Williams, *Morning Consult*, "'Buy Now, Pay Later' Users Significantly More Likely to Overdraft Than Nonusers" (Mar. 2, 2022), <https://morningconsult.com/2022/03/02/buy-now-pay-later-bnpl-overdraft-data/>.

³⁵ *Id.*

³⁶ U.K. Financial Conduct Authority, *The Woolard Review - A Review of Change and Innovation in the Unsecured Credit Market* (Feb. 2, 2021), <https://www.fca.org.uk/publication/corporate/woolard-review-report.pdf> [hereinafter U.K. Financial Conduct Authority, *Woolard Review* (Feb. 2021)].

funds fees can be incredibly damaging to consumers as overdraft and NSF fees are highly associated with closed bank accounts, leading to financial exclusion.³⁷

In addition to the risk of bank fees, most providers require consumers to link the BNPL credit to a credit or debit card at check out and authorize payments to be automatically deducted. Auto-pay reduces the provider's incentive to underwrite and may violate the consumer's right to revoke this authorization, which is protected by the ban on compulsory repayment by the Electronic Fund Transfer Act (EFTA).³⁸ This preauthorization also makes it difficult for consumers to exercise dispute rights for returns, cancelled, or non-delivered items.

Further, allowing or requiring repayment by credit card is even more alarming.³⁹ Using a credit card to pay off other forms of debt is a practice that credit card issuers often do not permit with traditional debt, like mortgages and student loans. Despite that, a recent Credit Karma survey found that 22% of respondents used a credit card to pay off a BNPL account.⁴⁰ For those with revolving credit, the BNPL charge will trigger interest from the day it is posted.

Although we know consumers do use a single BNPL provider multiple times in the same month,⁴¹ there is no way for BNPL providers to assess how many outstanding BNPL products a consumer has on other platforms, meaning the provider cannot see the scope of BNPL debt and thus meaningfully assess a consumer's ability to repay. In addition, there are concerns about consumers buying more with BNPL than without, making this lack of knowledge even more concerning. One survey found that more than ~~42%~~⁴² ~~43%~~⁴³. Although the terms may be attractive, there are concerns about these products being marketed to people who cannot afford them, which can mean that buying more equates to unmanageable debt loads.

Additional concerns exist beyond insufficient underwriting. Consumers do not have the same dispute and chargeback rights as they do with credit cards, and because both a merchant and BNPL provider are involved in a return process, it can be complicated and difficult for the consumer. If a consumer has a problem with the product purchased, refund and return rights vary between providers, and information about these rights is difficult to find. A report by U.S. PIRG found that many consumers were required to keep paying the BNPL provider as the merchant and lender went back and forth about the return process.⁴⁴ Even for canceled or non-delivered

³⁷CRL, Statement for the Record: *Overdraft Fees Cause Financial Exclusion; Policymakers Must Act Hearing on "Banking the Unbanked: Exploring Private and Public Efforts to Expand Access to the Financial System" Before the U.S. House Committee on Financial Services, Subcommittee on Consumer Protection and Financial Institutions* (July 21, 2021), <https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-testimony-overdraft-financial-exclusion-21jul2021.pdf>.

³⁸ See CRL, CFA, NCLC, BNPL Comments (2022), pg. 41.

³⁹ See for example, Splitit charges all payment to a credit card rather than a bank account, see terms and conditions, (last accessed September 11, 2022) <https://www.splitit.com/shopper/>.

⁴⁰ Claire Ballentine, *Bloomberg News for American Banker*, "How buy now/pay later services are boosting American credit card debt" (March 18, 2022), <https://news.bloomberglaw.com/banking-law/buy-now-pay-later-services-are-boosting-u-s-credit-card-debt>.

⁴¹ Cardify, *Convenience, Debt, and Novelty: Analyzing BNPL Consumer Data* (Sept. 8, 2021), <https://www.cardify.ai/reports/bnpltrend-report>.

⁴² Wang, Consumer Reports, Hidden Risks (Feb. 2021).

⁴³ Erika Giovanetti, Lending Tree, "Shoppers Use 'Buy Now, Pay Later' Financing to Purchase Things They Can't Afford" (April 20, 2021), <https://www.lendingtree.com/personal/buy-now-pay-later-survey/> [hereinafter Lending Tree, BNPL (2021)].

⁴⁴ Mierzewski and Litt, U.S. PIRG, BNPL (Mar. 2022).

items, consumers can be charged, or even charged more than once.⁴⁵ Other consumers may never receive their refund.⁴⁶ Plus, a U.K study found that consumers still viewed BNPL as a financial service that was regulated and came with associated protections. Consumers may believe that they have the same chargeback rights protected under law as with credit cards.⁴⁷

Although BNPL has been touted as a credit building product, there are more potential risks than benefits to a consumer's credit score unless these products are reported correctly. The way in which BNPL credit is reported matters. Even for consumers that make on-time payments, reporting within the current system may lower their credit score as the current system is an inappropriate fit for BNPL. For consumers beleaguered by an unmanageable BNPL debt burden, the negative impact to their credit scores can be severe.

Based on the current plans, the nationwide Credit Reporting Agencies (CRAs) do not treat BNPL accounts in the same manner, which has the possibility to hamper any benefits.⁴⁸ Equifax has introduced a new industry code but will still allow BNPL providers to furnish data in the format of their choice.⁴⁹ In contrast, Experian⁵⁰ and TransUnion⁵¹ have announced that BNPL products would be reported to specialty bureaus. These inconsistencies will mean that any possible benefit to consumers will depend on the user's decision of how the data is reported and used, rather than the consumer's decision. The CFPB has already expressed concerns about these dissimilar approaches.⁵² Given the underwriting concerns and the potential damage to consumer credit reports, inconsistent reporting, the inclusion of delinquent data, and promotion of BNPL as a credit building product can be incredibly harmful to consumers.⁵³

Regardless of how the CRAs have begun to incorporate BNPL data, FICO scores of credit reports that have incorporated said data have lowered slightly.⁵⁴ FICO warns that this is because of the increase in the number of accounts and indebtedness on consumer credit reports with BNPL.⁵⁵ This trend, however slight, still illustrates that BNPL is not an easy fit within the current system and if mishandled, can lead to severe credit reporting issues and declines in credit scores.

⁴⁵ *Id.*

⁴⁶ AnnaMaria Andriotis, *Wall Street Journal*, "Shopping With Buy Now, Pay Later Is Easy. Getting a Refund Is Harder" (June 24, 2022) https://www.wsj.com/articles/shopping-with-buy-now-pay-later-is-easy-getting-a-refund-is-harder-11656051506?st=vo6fillpxii0rq&reflink=article_email_share.

⁴⁷ *Id.*

⁴⁸ Martin Kleinbard and Laura Udis, CFPB, "Buy Now, Pay Later and Credit Reporting" (June 15, 2022), <https://www.consumerfinance.gov/about-us/blog/by-now-pay-later-and-credit-reporting/> [hereinafter Kleinbard and Udis, BNPL and Credit Reporting (June 2022)].

⁴⁹ Equifax, "Equifax First to Formalize Inclusion of 'Buy Now, Pay Later' Payment Information in Consumer Credit Reports" (December 20, 2021), <https://investor.equifax.com/news-events/press-releases/detail/1204/equifax-first-to-formalize-inclusion-of-buy-now-pay>.

⁵⁰ Greg Wright, Experian, "Introducing The Buy Now Pay Later Bureau™ from Experian" (January 26, 2022), <https://www.experian.com/blogs/news/2022/01/26/buy-now-pay-later-bureau/>.

⁵¹ TransUnion, "TransUnion to Maximize Financial Inclusion Opportunities for the Nearly 100 Million Consumers Using BNPL Loans" (February 24, 2022), <https://newsroom.transunion.com/transunion-to-maximize-financial-inclusion-opportunities-for-the-nearly-100-million-consumers-using-bnpl-loans/>.

⁵² Kleinbard and Udis, BNPL and Credit Reporting (June 2022).

⁵³ CRL, CFA, NCLC, BNPL Comments (2022), at 17-21.

⁵⁴ Suna Hafizogullari, FICO, "How Might Buy Now, Pay Later Loans Impact FICO® Scores?" (June 20, 2022), <https://www.fico.com/blogs/how-might-buy-now-pay-later-loans-impact-fico-scores>.

⁵⁵ *Id.*

Debt collection poses risks for any credit product but can be even more severe for those that do not underwrite properly or push consumers into unmanageable amounts of debt. Consumer understanding of the terms of BNPL loans varies widely, with many consumers, especially younger consumers, not viewing BNPL as credit, according to a U.K. study.⁵⁶ If these products are not perceived as credit, consumers may not fully understand the consequences of failing to repay. For example, many BNPL companies refer accounts to third-party debt collectors, and consumers consent to that in the initial terms and conditions.⁵⁷ Depending on provider, consumers may also consent to receiving debt collection emails and phone calls and authorizing the transfer, sale, or assignment of the debt to another entity like a debt buyer. Although default is not readily discussed as a consequence of BNPL credit, one study found that 1 in 10 consumers had defaulted on their BNPL credit product.⁵⁸ Further, consumer complaints to the CFPB illustrate that debt collection poses a great risk, with 25% of complaints about BNPL to the CFPB about debt collection.⁵⁹ These products are credit and carry the same consequences for defaulting as other types of loans.

Lack of clear and uniform consumer disclosures and statement requirements make it difficult for consumers to understand the exact cost of the credit, to compare costs amongst providers, and to keep track of multiple BNPL credit products at a given time. Under TILA, credit card providers are required to provide a billing statement that includes the amount and date of each credit extension, the payment due date, any finance charge or fees, the total charges calendar year-to-date, and the creditor's address for billing error purposes.⁶⁰ This critical information is provided in a clear, easily accessible manner. However, BNPL providers are not required to uniformly or clearly disclose how much these fees are, where to find information about fees, and whether these fees are capped. Some fees are listed in the terms and conditions, while others are listed in an installment agreement or in "frequently asked questions" sections on websites. Certain products contain disclosures about the possibility of a fee without an indication of the amount of that fee. Plus, one survey found that although seven in ten BNPL users were charged interest or fees for missed payments, fewer than one-third of users knew what those fees or interest would be before entering into the agreement.⁶¹

Further, each consumer purchase of a product or good is financed with its own payment plan and has its own payment due dates, as opposed to a single, monthly payment like other forms of credit. A single monthly payment is easier to track and manage than various payments throughout the month. Consumers with multiple BNPL credit products may find it difficult to track since due dates vary based on the date of purchase. Plus, some providers also charge

⁵⁶ U.K. Financial Conduct Authority, Woolard Review (Feb. 2021).

⁵⁷ CRL, CFA, NCLC, BNPL Comments (2022) at 24-28.

⁵⁸ Citizens Advice, "One in 10 Buy Now Pay Later shoppers have been chased by debt collectors" (Sept. 3, 2021), <https://www.citizensadvice.org.uk/about-us/about-us1/media/press-releases/one-in-10-buy-now-pay-later-shoppers-have-been-chased-by-debt-collectors/>.

⁵⁹ Mierzwinski and Litt, U.S. PIRG, BNPL (Mar. 2022).

⁶⁰ Reg. Z § 1026.7

⁶¹ Lending Tree, BNPL (2021).

rescheduling fees for consumers who need to move their payments, making it burdensome for consumers to change the payment schedule should an unexpected financial obligation arise.⁶²

Like with many of the products discussed today, BNPL providers harvest and store immense amounts of consumer data. Consumer payment, purchase history, and other personal information may be improperly used by BNPL providers. For example, earlier this year, the CFPB raised concerns about Apple's data misuse with its BNPL product.⁶³

Although BNPL offerings typically provide financing for goods and clothing, these products are shifting into new market areas, including groceries, student loans, travel, and even medical debt. In fact, in a forthcoming survey of 1200 LMI Latino consumers, UnidosUS, the nation's largest Hispanic civil rights organization, found that although only 14% of respondents have used a Buy Now Pay Later (BNPL) product, 49% of those respondents used BNPL for necessities such as groceries, gas, utilities, and household supplies.⁶⁴ That number goes up to 62% for respondents who are unbanked and don't have a credit card.⁶⁵ Using BNPL for groceries and other necessities may push consumers, especially those who are already overextended and lack other forms of credit, into unmanageable debt loads.

In addition, the Student Borrower Protection Center found that fifty unaccredited and/or unregulated for-profit schools marketed BNPL as a student loan offering.⁶⁶ BNPL providers for student loans have shifted into for-profit credentialing bootcamps, which lack any regulatory oversight and appear to not provide graduates with any of the promised benefits and career prospects.⁶⁷

With a similar structure to other BNPL plans, these financing options offer no interest and no hard credit check, often with similar terms and conditions, including unexpected fees, limited or no underwriting, no chargeback rights, and mandatory arbitration agreements. However, in certain market areas, BNPL can be even more problematic for consumers.

D. Recommendations

As explained in joint comments CFA and fellow consumer organizations filed with the CFPB, BNPL providers are within the scope of TILA and should be treated as "Card Issuers" subject to all credit card protections codified by TILA.⁶⁸ As clearly illustrated in those comments, BNPL providers offer consumers an open-end credit device that is designed for repeat use and has a

⁶² See Sezzle provides one free reschedule on every order, but charges fees for any payment moves beyond that, see <https://shopper-help.sezzle.com/hc/en-us/articles/360045946992-How-do-I-reschedule-a-payment> (last visited September 11, 2022).

⁶³ Ron Shevlin, *Forbes*, "Apple Accused Of Potential Consumer Data Misuse With Its 'Buy Now, Pay Later' Service (July 27, 2022) <https://www.forbes.com/sites/ronshevlin/2022/07/27/cfpb-accuses-apple-of-misusing-consumer-data-with-its-buy-now-pay-later-service/?sh=6d3afa6f555d>

⁶⁴ UnidosUS, Survey of 1200 Low to Moderate Income Latino Consumers (forthcoming) (2022).

⁶⁵ *Id.*

⁶⁶ SBPC, Point of Fail (March 2022).

⁶⁷ *Id.*

⁶⁸ For legal analysis see CRL, CFA, NCLC, BNPL Comments (2022) at 29-35.

replenishing credit line.⁶⁹ Indeed, they have all the core functions to be designated a credit card under both the general TILA definition and the CARD Act definition.⁷⁰

We urge the CFPB to clarify that BNPL products are credit cards, subject to the fee disclosures, ability-to-repay requirements, reasonable and proportional penalty fees, chargeback protections, dispute rights, standard statement requirements, and appropriate and helpful credit reporting practices that apply to credit cards. These protections would ensure that consumers have the same basic protections they do when using other forms of credit.

Beyond the CARD Act, federal and state regulators should provide necessary oversight and supervision of BNPL providers, ensuring that they are not engaging in unlawful discrimination or unfair, deceptive or abusive acts or practices. Although many of these closed-end credit products largely do not carry periodic interest, most have late fees, missed, or rescheduled payment fees, and other finance charges that should not be permitted to exceed the allowable interest and fees for active-duty military under the MLA. Further, many of these products include mandatory arbitration agreements, which covered military members should be exempt from as established by the MLA.

In addition, given that consumers of color use BNPL at higher rates than white consumers, it is incredibly important that state and federal regulators enforce anti-discrimination laws to ensure that there are not disparate impacts on certain consumers.

The CFPB should also ensure that BNPL providers are compliant with EFTA's ban on compulsory repayment by electronic transfer. In addition, since many terms and conditions include consent to receive communication from third-party debt collectors, they should also be compliant with the Fair Debt Collection Practices Act (FDCPA).

State regulators should require lenders to abide by applicable licensing and usury laws. State and federal regulators should make sure that lenders are not charging unfair fees or shifting into an abusive fee model.

Finally, state and federal regulators should consider collecting data on these programs to better understand the risks associated with them.

2. Earned Wage Advance (EWA) Products

A. Introduction

Earned Wage Advances (EWA) are an employer-based form of credit. Employees can use EWAs to take out an advance ahead of payday for wages they have earned but have not yet been paid. The third-party EWA provider uses the employer's time and attendance system to gauge how much an employee has earned. The EWA provider then advances those funds to the employee, which are repaid to the EWA provider through a variety of avenues: the EWA can deduct the employee's payroll; the provider can offset the employee's next direct deposit to an associated debit or payroll card; the provider can intercept wages through an intermediate pass-through

⁶⁹ *Id.*

⁷⁰ *Id.*

account; or the provider can debit the worker's bank account directly. The final option creates the risk for consumers of overdraft and nonsufficient fund fees. Use of these products has grown recently, with \$9.5 billion moved by EWA providers in 2020 according to the Aite-Novarica Group.⁷¹

Regardless of structure, a fee-based EWA product is essentially a payday loan—a product where a third-party advances funds to a consumer ahead of the consumer's payday and is then repaid in some fashion out of the next paycheck—regardless of whether it's lower than a traditional payday loan.

Further, many of these providers charge both access fees and inflated expedite fees, for the consumer to access funds immediately (more on fees below). EWAs with fees require an employee, often lower-wage, hourly employees, to pay to be paid. Although there is a trend towards employers covering the cost of these fees as an employee benefit, these programs still may lead consumers into a cycle of reborrowing and turning to higher priced forms of credit.

Further study of free EWA products is needed, and employers should focus on paying a living wage; consistent, predictable work schedules; employee savings programs; and affordable small dollar installment loans instead of encouraging employees to spend their paycheck early. Regardless of their structure, these products are not risk-free, and fee-based EWA programs should be regulated as credit.

B. Consumer Risks

Although there is a trend towards offering EWA products to employees for free, many still charge fees. These fees are normally \$1 to \$2 per advance and sometimes have a weekly or biweekly cap. Many providers also limit advances to 50% of expected net wages. Although these fees are smaller than traditional payday loan fees, EWAs are still balloon payment loans that can lead to a cycle of reborrowing and cascading fees. These products are largely marketed and used by hourly, minimum wage workers, which means that even a \$1 or \$2 fee can make a substantial difference and leave a hole in next week's paycheck.

Consumers may be faced with both an access fee, to access the advance, as well as an inflated expedite fee, to access the advance immediately. These expedite fees can cost consumers \$1-2 more than the initial access fee. Nearly 90% of users opt for instant access—not surprising given that these products are marketed towards lower wage workers who struggle to make ends meet between paydays.⁷²

⁷¹Ryan Deffenbaugh & Veronica Irwin, *Protocol* "Fintech wants to pay workers faster. The CFPB might have a word" (July 25, 2022), <https://www.protocol.com/fintech/cfpb-earned-wage-access>.

⁷²Lauren Saunders, NCLC, *Testimony to Task Force on Financial Technology U.S. House Committee on Financial Services Hearing on "Buy Now, Pay More Later? Investigating Risks and Benefits of BNPL and Other Emerging Fintech Cash Flow Products"* (Nov. 2, 2021), <https://financialservices.house.gov/uploadedfiles/hrg-117-ba00-wstate-saundersl-20211102.pdf>.

Further, these fees are inflated well beyond the cost the provider faces for sending the money instantly. For example, many EWA providers have access to the Clearing House's RTP network. The \$1 to \$2 charged to consumers for instant access severely exceeds the \$0.45 cost to the provider for instant transfer.⁷³ The costs of Visa Direct and MasterCard Send are likely in a similar range.⁷⁴

Repeat usage is common, multiplying the fees even further. Most users rely on these products around 24 times a year, but frequency can span between 12 times to 120 times per year.⁷⁵ For the average user, they utilize an EWA twice per month. Another 2021 survey found that 70% of EWA users took out consecutive advances.⁷⁶

Although many workers see the access fee for standard delivery as the price of the product, the expedite fees and repeat usage rack up the price dramatically. At one provider, a worker could pay up to \$36 a month at the high end, assuming a repeat user who takes 12 instant accesses in a month.⁷⁷ Some providers have even higher cost models.

In addition to the fees, overreliance, and potential cycle of reborrowing, we have additional concerns about the business model. For those providers that require authorization to debit a consumer's bank account, repayment requests can lead to abusive attempts to collect payment and cause consumers to rack up overdraft and NSF fees⁷⁸ Additionally, as with many fintech providers, EWA providers compile massive amounts of employment and wage data, which can lead to a host of concerns.⁷⁹ For example, data collection can lead to vulnerable concerns being targeted for credit products they cannot afford.

These products are marketed to hourly, minimum, or lower wage workers that are likely to face income volatility from week to week. Regardless of the size of the fee, it's still money that's lost from the consumer's paycheck. Further, accessing their pay early leaves a hole in the following week's budget. We worry that that hole leads to further borrowing, or worse, turning to higher-cost forms of debt. While some users of EWA products have reported lower usage of payday

⁷³ The Clearing House, *Simple, Transparent, Uniform Pricing for All Financial Institutions* (last visited Apr. 25, 2022).

⁷⁴ See for example, this article noted that Uber drivers paid \$0.50 to get instant access to their pay through Visa Direct. Tom Groenfeldt, *Forbes*, "Visa Direct Is The Engine Behind Zelle and Venmo" (Mar. 15, 2019), <https://www.forbes.com/sites/tomgroenfeldt/2019/03/15/visa-direct-is-the-engine-behind-zelle-and-venmo/?sh=1814efc58739>.

⁷⁵ Letter from NCLC & CRL to California Department of Financial Protection & Innovation at 8-12 (Mar. 15, 2021), https://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/CRL_CA_DFPI_EWA_Comments.pdf [hereinafter NCLC & CRL, Letter to CA DFPI (Mar. 2021)].

⁷⁶ Financial Health Network, "Earned Wage Access and Direct-to-Consumer Advance Usage Trends" (June 25, 2021), <https://finhealthnetwork.org/research/earned-wage-access-and-direct-to-consumer-advance-usage-trends/>.

⁷⁷ NCLC & CRL, Letter to CFPB (Oct. 12, 2021), re "Concern about prior leadership's finding that certain earned wage access products are not "credit" under TILA" (October 12, 2021).

https://www.nclc.org/images/pdf/banking_and_payment_systems/fintech/EWA-letter-to-CFPB_Oct-4-2021.pdf [hereinafter NCLC/CRL, EWA Letter to CFPB (October 2021)].

⁷⁸ NCLC/CRL EWA Letter to CFPB (October 2021).

⁷⁹ Caitlin Harrington, *WIRED*, "Workers Are Trading Staggering Amounts of Data for 'Payday Loans'" (March 23, 2022), <https://www.wired.com/story/payday-loan-data/>.

loans and overdraft fees, these products are still a balloon payment loan that can lead to a cycle of reborrowing and cascading fees far higher than the initial ticket price and should still be subject to oversight and monitoring.⁸⁰

C. Recommendations

Under Director Kraninger, the CFPB issued a deeply problematic advisory opinion about EWA products⁸¹ and an approval order to PayActiv for its EWA product under the CFPB's then active, compliance assistance sandbox.⁸² CFA joined nearly 100 consumer, labor, civil rights, legal services, faith, community, and financial organizations in advocating that the CFPB revoke this approval order, rescind the advisory opinion and treat these products as credit covered by TILA.⁸³ Fortunately, this approval order was rescinded earlier this year and in doing so, the CFPB said it planned to "provide greater clarity concerning the application of the definition of "credit" under the Truth in Lending Act and Regulation Z."⁸⁴

We look forward to the CFPB's revisit of this advisory opinion and urge that they clarify that EWAs provide credit to consumers. Although free EWA products may fall outside of the scope of TILA, those that charge fees are within the scope.⁸⁵ Access and expedite fees charged by EWA providers are finance charges that should be presented to consumers in terms of an annual percentage rate.⁸⁶ State regulators should also regulate these fee-based earned wage access products as credit covered by all state credit regulations and laws, including usury laws.

Regardless of structure, a product where a third-party advances funds to a consumer ahead of the consumer's payday and is then repaid in some fashion out of the paycheck is a loan. We are greatly concerned about the potential harms of viewing these fee-based earned wage access products as something other than credit, leading to evasion of consumer protection and fair lending laws. Treating EWA products as credit does not mean these products should not exist. It merely means that consumers have the same basic consumer protections and disclosures as they do when using other forms of credit—a concept that is likely already expected. Moreover, failing to regulate them as credit will invite payday lenders and other high-cost lenders to enter this market, which could lead to even more exploitive rates and practices.

In addition, the CFPB should address inflated expedite fees either through TILA or through its authority to protect consumers from Unfair, Deceptive and Abusive Acts and Practices

⁸⁰DailyPay, "Our Survey Says ... DailyPay Saves Employees, On Average, \$1,205 Per Year" (May 14, 2020), <https://www.dailypay.com/blog/our-survey-says-dailypay-saves-employees/>.

⁸¹CFPB, Advisory Opinion, 12 CFR Part 1026, Truth in Lending (Regulation Z); Earned Wage Access Programs (Nov 30, 2020), https://files.consumerfinance.gov/f/documents/cfpb_advisory-opinion_earned-wage-access_2020-11.pdf.

⁸²CFPB, "Consumer Financial Protection Bureau Issues an Approval Order to Facilitate Employee Access to Earned but Unpaid Wages" (December 30, 2020), <https://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-issues-an-approval-order-to-facilitate-employee-access-to-earned-but-unpaid-wages/>.

⁸³Letter from NCLC, CRL, CFA, et. al., to Consumer Financial Protection Bureau re "Rescind earned wage access advisory opinion and sandbox approval and treat fee-based earned wage access products as credit" (Oct. 21, 2021), <https://consumerfed.org/wp-content/uploads/2021/10/CFA-joins-Groups-in-Urging-CFPB-to-Reverse-Earned-Wage-Actions-that-Threaten-to-Create-Dangerous-Fintech-Payday-Loan-Loopholes-10.12.21.pdf>.

⁸⁴CFPB, "CFPB Rescinds Special Regulatory Treatment for Payactiv" (June 30, 2020), <https://www.consumerfinance.gov/about-us/newsroom/cfpb-rescinds-special-regulatory-treatment-for-payactiv/>.

⁸⁵For further legal analysis see NCLC/CRL, EWA Letter to CFPB (2021).

⁸⁶*Id.*

(UDAAP). We also recommend that the CFPB further supervise these fee-based EWA providers and conduct research on the impact of EWA programs, especially on low-income consumers and their ability to build wealth and achieve financial security.

Fintech providers that purport to lend earned wages and seek access to a consumer's bank account, but are not employer integrated, are essentially a payday loan and should be supervised and regulated as such.

3. The "Tip" Model, used to pay for earned wage access, overdraft protection, cash advances, and loans:

A. Introduction

Increasingly, nonbank fintech providers are charging consumers "tips" for financial products, including faux early wage access, "peer-to-peer" cash advances, overdraft protection, and other forms of credit.⁸⁷ Although providers claim that these fees are purportedly voluntary, tips are simply disguised finance charges and should be treated as such.

Certain nonbanks offer consumers enticing promises of fee-free overdraft protection, claiming that overdraft fees have gotten out of hand. However, the overdraft protection offered still comes at a price—consumers are asked to "tip" to help other users make ends meet or pay for the cost of the service.⁸⁸ Another provider offers consumers cash advances for no interest, no monthly fee, and no credit check, "unlocking" higher cash advances each time they use the service. However, consumers are asked to leave a "small optional tip" to help cover costs of the product.⁸⁹ Some providers collect tips in addition to subscription and expedite fees.⁹⁰ Other providers charge consumers tips for payday advances that claim to be "earned wage access" products but in actuality have no connection to employer payroll or an employee's actual earnings.⁹¹

By labeling these finance charges as "tips," financial providers are attempting to mask finance charges, evade interest rate limits and other consumer protection laws, and disguise overdraft fees. These tips are not truly voluntary as companies use a number of means to ensure that the consumer tips. The label does not change the cost to consumers; instead, it allows providers to disguise the true cost of credit, deceiving consumers into larger finance charges than originally disclosed.⁹²

B. Consumer Risks

⁸⁷See NCLC, CFA, CRL, and Americans for Financial Reform (AFR), Comments to CFPB re "Request for Information Regarding Junk Fees Imposed by Providers of Consumer Financial Products and Services," at 46-47 (May 2, 2022), <https://consumerfed.org/wp-content/uploads/2022/05/Groups-Submit-Comments-in-Response-to-CFPBs-Request-for-Information-Regarding-Fees-Imposed-by-Providers-of-Consumer-Financial-Products-or-Services-5.2.22.pdf> [hereinafter NCLC, CFA, et. Al, Junk Fee Comments to CFPB (May 2022)].

⁸⁸See SpotMe, <https://www.chime.com/spotme/> (last visited September 6, 2022).

⁸⁹See Instacash, <https://www.moneylion.com/instacash/> (last visited September 6, 2022).

⁹⁰See <https://www.joinklover.com/> (last visited September 6, 2022).

⁹¹See <https://www.earnin.com/> (last visited September 6, 2022).

⁹²For sample of complaints regarding tips, see Gittleman, Statement re BNPL (March 2022).

These “tips” are not truly voluntary due to a variety of techniques companies use to make it difficult not to tip. Although there seems to be an assumption that so-called tips are voluntary and consumers must opt into them, companies are utilizing a variety of strategies to make it difficult not to tip or to make the consumer feel compelled to tip. Strategies include adding a default tip that must be removed each time; or denying or reducing future credit if a consumer fails to tip enough. Further, one colleague recounted that he found it impossible to undo the default tip option even after deleting and reinstalling the app. Even without manipulative strategies, consumers are more likely to feel compelled to tip for fear of being treated differently or denied access in the future.⁹³

Tips are inherently deceptive and deceitful. Tips are not often included in product marketing and promotions or even in information about fees in the product terms and conditions. This leads consumers to believe that these products are free, especially when promoted with promises of no interest or monthly fees. By labeling a finance charge as a tip, providers are relying on the obligation that consumers often feel when tipping another human after completion of a service, like in restaurants or other service industries. Some providers further encourage that feeling by labeling tips as “lender appreciation” tips.⁹⁴ Other providers make disingenuous statements about how tips support a “community” or will help other “users make ends meet” or deceitfully labeling tips as “donations.”

However, these tips do not go to another human being and are not in appreciation of a service—instead, they go to the company’s bottom line. Further, tips are added to the repayment amount before the transaction is fully completed and tips are paid via the authorization to debit a user’s account per user contracts. Consumers do not tip after the service has taken place in appreciation for good service which might make them more voluntary. The label does not change the inherent nature of these charges; it simply allows providers to claim otherwise.

Tips increase the cost of credit, can add up quickly, and consumers have no way to compare that cost with other forms of credit. The “tip” model takes advantage of consumers’ lack of awareness of how tips add up, especially since small tips can add up to a high cost over time nearing payday loan pricing and thus, can make it easier for consumers to get sucked into the cycle of debt. For example, a voluntary tip can be near \$15 per \$100, similar pricing to that of payday loans — one provider encourages users to leave a tip of \$0 to \$14 on a \$100 weekly loan, which would equate to 730% APR.⁹⁵ Another provider was recently issued a cease-and-desist order for charging tips equivalent to 43% to 4280% APR, far above the legal rate in most states.⁹⁶

Not only is this rate illegal in states throughout the country, but the pricing may also look cheap to consumers on its surface because it’s portrayed as a flat fee rather than APR. It is marketed in ways to hide the true cost or dismiss the APR as irrelevant due to the shorter loan cycle. Plus, tip

⁹³ For further analysis of whether tips are ‘voluntary,’ see NCLC & CRL Letter to CA DFP (Mar. 2021) at 8-12.

⁹⁴ See <https://solofunds.com/> (last visited September 6, 2022).

⁹⁵ Kevin Dugan, *NY Post*, “Cash-advance App Earnin Gets Subpoenaed by NY Regulator: source” (Mar. 29, 2019), <https://nypost.com/2019/03/28/cash-advance-app-earnin-gets-subpoenaed-by-ny-regulator-source/>.

⁹⁶ Penny Crossman, *American Banker*, “Connecticut slaps fintech Solo Funds with cease-and-desist order” (May 11, 2022), <https://www.americanbanker.com/news/connecticut-slaps-fintech-solo-funds-with-cess-and-desist-order> [hereinafter Crossman, *American Banker*, Solo Funds (May 2022)].

models rely on the consumers' assumption that they will not be able to access the product in the future if they don't tip.⁹⁷

But these high charges for smaller loans result in exorbitantly high APRs, regardless of whether they are portrayed to consumers in that way. Regardless of the label, advances that charge tips are balloon payment loans, with repayment on the next deposit or other equally short schedule. Like other balloon payment loans, they can lead to dependency or a cycle of reborrowing, and high rates of overdraft and NSF fees.

Finally, consumers have no way to compare the cost of tips to other forms of credit because they are often added late in the application process and are not presented in terms of APR, like with other credit sources. These tactics help disguise the true cost of credit and the potential impact on borrowers.

C. Recommendations

Even if voluntary, tips could be considered finance charges under the Truth in Lending Act (TILA) and therefore, subject to state usury laws and fair lending laws. Regardless of how the charge is labeled to a consumer, the cost remains the same. Most borrowers likely do not understand how high an interest rate they are paying, and even if some borrowers are able to translate the fees or tips into APRs, these fees should still be subject to consumer protection laws. Labeling interest as a "tip" does not change its cost to the consumer and should not exclude it from usury law.

In addition, the CFPB should supervise tip-based cash advances as payday loans under its supervision authority. Providers promote themselves as alternatives to traditional payday loans, with some even marketing borrowing with "no debt traps."⁹⁸ The CFPB should use its supervision authority to ensure that the opposite is not the case.

Finally, the CFPB should enforce the MLA's 36% rate cap against tip-based credit products. Regardless of the label, tips are finance charges and should be subject to the MLA's interest rate cap that covers active-duty service members and their families.

State regulators should aggressively enforce their banking regulations and usury laws. For example, Connecticut and New York regulators have each accused fintech providers of claiming tips are voluntary, but then only providing loans to those consumers that pay tips. These regulators have argued that these providers failed to apply for the proper lending and collections licenses and failed to disclose the tips.⁹⁹ Other state regulators should follow suit.

Failing to regulate these so-called "tips" as finance charges will enable dangerous erosions of fair lending laws and usury laws across the country. The CFPB should provide much needed oversight of finance providers that utilize the dangerous tip model and ensure that these providers comply with consumer protection laws and are not engaging in unfair, deceptive or abusive acts and practices.

⁹⁷ For consumer examples of tip models, see NCLC & CRL, Letter to CA DFPI at 8-12 (Mar. 2021).

⁹⁸ See <https://solofunds.com/borrow/> (last visited September 6, 2022).

⁹⁹ Crossman, *American Banker*, Solo Funds (May 2022).

4. Training Repayment Agreement Provisions

A. Introduction

Training Repayment Agreement Provisions, or TRAPs, are a form of employer-driven debt that can trap consumers in tens of thousands of debt with high interest rates and the threat of third-party debt collection. TRAPs require employees who receive on-the-job training to pay back the alleged cost of training to their employer if they try to leave their job, either voluntarily or involuntarily, before an arbitrarily determined date ranging from months to years after employment.¹⁰⁰ The training is often of questionable necessity and quality, and if the agreement is enforced, traps consumers in tens of thousands of dollars of debt.¹⁰¹ For some workers, the potential cost of the agreement is greater than their yearly salary.¹⁰² If workers bound by a TRAP attempt to leave their job before the predetermined date, they can face exorbitant interest rates, attorney and collection fees, and withholding of pay or retirement savings.¹⁰³ Even if not enforced, the threat of this debt and ensuing consequences function as a deterrent for leaving a job. These provisions keep employees in often low-paying jobs with poor working conditions.

The use of TRAPs is widespread and growing more commonplace. These provisions are buried deep inside employment contracts of many major employers, including trucking companies, hospital operators, retailers, roofing contractors, financial services firms, airlines, and more. The Student Borrower Protection Center estimates that companies that collectively employ more than one in three private-sector workers use TRAPs in employee contracts.¹⁰⁴

TRAPs hinder workplace mobility which can exacerbate disparities. TRAPs are used in jobs that are disproportionately held by women, immigrants, and Latino and Black employees. With the threat of debt hanging over their head, employees can feel forced to stay in substandard working conditions with poor pay. TRAPs can disempower workers from fighting disparities, undermine their bargaining power, and limit their ability to use mobility as a solution.

B. Recommendations

First off, we appreciate Chairman Sherrod Brown, Chairwoman Patty Murry of the Senate Health, Education, Labor, and Pensions Committee, and their colleagues writing to the CFPB to urge them to provide much needed oversight of TRAPs.

Recently, CFA joined a coalition of groups in response to the CFPB's request for information about employee driven debt. The coalition urged the CFPB to have an important role in

¹⁰⁰ SBPC, Trapped at Work: How Big Business Uses Student Debt to Restrict Worker Mobility (July 2022), https://protectborrowers.org/wp-content/uploads/2022/07/Trapped-at-Work_Final.pdf [hereinafter SBPC, Trapped at Work (July 2022)].

¹⁰¹ *Id.*

¹⁰² *Id.*

¹⁰³ *Id.*

¹⁰⁴ *Id.*

protecting consumers against industry abuses where these provisions exist.¹⁰⁵ First, the CFPB should vigorously enforce the prohibition against unfair, deceptive, or abusive acts and practices (UDAAPs), and other essential consumer protection laws such as TILA and the Equal Credit Opportunity Act (ECOA), to protect against industry abuses where these provisions currently exist. In addition, the CFPB should routinely supervise debt collectors that collect debts arising from TRAPs. Finally, the CFPB should exercise its market monitoring authority to identify consumer harm before it happens.

In addition, the Federal Trade Commission (FTC) should use its broad authority to protect consumers from unfair and deceptive labor practices. The FTC has broad authority to interpret “unfair methods of competition,” and it should use that authority to prohibit practices like TRAPs that hold back labor competition.

Finally, the Department of Labor, state agencies, and state policymakers have a responsibility to protect consumers from these abusive provisions, as TRAPs are often used to evade existing state and federal worker protections, including state-level bans on noncompete clauses.

5. Rent-a-Bank Loans

A. Introduction

Since the American Revolution, states have had the power to set their own interest rate caps. Today, more than 45 states and the District of Columbia have interest rate caps on installment loans.¹⁰⁶ However, due to consistent deregulation, banks are largely exempt from state interest rate caps. High-cost lenders are exploiting that exemption to evade state interest rate laws. Multiple predatory lenders launder their triple-digit loans through rogue FDIC-supervised banks, even in states where those rates are illegal.

On a bipartisan basis, Congress recently expressed its strong disapproval of predatory rent-a-bank schemes when it adopted a Congressional Review Act resolution to overturn the Office of the Comptroller of the Currency’s (OCC) “fake lender” rule.¹⁰⁷ This bipartisan legislation was also supported by 25 State Attorneys General, the Conference of State Bank Supervisors, the National Association of Consumer Credit Administrators, the National Association of Federal Credit Unions, Credit Union National Association, 138 scholars from 44 states, and more than 400 civil rights, community, consumer, disability rights, faith, housing, labor, legal services, senior rights, small business, and veterans organizations from all 50 states.¹⁰⁸

In signing the resolution, President Biden, stated:

¹⁰⁵ SBPC, CFA, et. al, Comments to CFPB re Request for Information Regarding Employer-Driven Debt (Docket No. CFPB-2022-0038) (September 9, 2022), <https://consumerfed.org/wp-content/uploads/2022/09/Employer-Driven-Debt-RFI-Coalition-Comment.pdf>.

¹⁰⁶ NCLC, *State Rate Caps for \$500 and \$2,000 Loans* (July 2021), https://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/FS_State_Rate_Caps_2021.pdf.

¹⁰⁷ Sylvan Lane, *The Hill*, “Senate votes to repeal OCC ‘true lender’ rule” (May 11, 2021), <https://thehill.com/policy/finance/552992-senate-votes-to-repeal-occ-true-lender-rule/>.

¹⁰⁸ Stop the Debt Trap Coalition, *Who Supports Overturning the OCC’s “Fake Lender” Rule?*, (April 2021), <https://consumerfed.org/wp-content/uploads/2021/04/Who-Supports-the-CRA.pdf>.

“The ... bill will protect borrowers against predatory lenders. In many states, these lenders are kept in check by caps on how much interest they can charge, but some loan sharks and online lenders have figured out how to get around these limits ... - by using a partnership with a bank to avoid the state cap and charging outrageous interest... -- some as high as 100 percent interest, which is astounding... “These are so called “rent-a-bank” schemes. And they allow lenders to prey on veterans, seniors, and other unsuspecting borrowers... trapping them into a cycle of debt. And the last administration let it happen, but we won’t.”¹⁰⁹

Despite this bipartisan rebuke, rent-a-bank schemes persist. We are currently aware of six rogue FDIC-supervised banks that are helping multiple predatory lenders peddle loans with interest rates as high as 225% APR, even in states where that rate is illegal.¹¹⁰

B. Consumer Risks

Complaints to the CFPB about these predatory lenders illustrate the abusive and deceptive practices used by these companies.¹¹¹ Consumers have cited rates of 96% to 189%, sometimes in states where those rates are illegal and even to servicemembers, veterans or their family members. Rates this high create payments for months and years with little reduction to the loan balance.

According to consumer complaints, the application process is a nightmare from start to finish. Consumers are lured in with promises of full interest rebates if paid in 90 days, but then find it difficult to avoid interest. Further, consumers complain of only having access to an application on a cellphone where it’s difficult to read the fine print, which includes critical information about high interest rates and other terms. Plus, consumers complain of administrative errors which can lead to deprivation of the rebate or missed payments.

Once the loan is taken out, paying it back is difficult with consumers complaining of improper processing of automatic payments. This can lead to late payments or inability to get the interest rebate. When consumers run into these hardships, they are faced with little or no response from disputes and rude or unhelpful customer service.

Moreover, consumers face harm to their credit reports, including when loans are reported incorrectly or fully paid back, and difficulties from debt collection, with collectors even failing to

¹⁰⁹ Remarks by President Biden Signing Three Congressional Review Act Bills Into Law: S.J.RES.13; S.J.RES.14; and S.J.RES.15 (June 30, 2021) <https://www.whitehouse.gov/briefing-room/speeches-remarks/2021/06/30/remarks-by-president-biden-signing-three-congressional-review-act-bills-into-law-s-j-res-13-s-j-res-14-and-s-j-res-15/>

¹¹⁰ NCLC, High-Cost Rent-a-Bank Loan Watch List (last visited September 3, 2022),

<https://www.nclc.org/issues/high-cost-small-loans/rent-a-bank-loan-watch-list.html>

¹¹¹ See Stop the Debt Trap Coalition, *Predatory Puppy Loans by TAB Bank and EasyPay Finance* (February 2022),

https://www.nclc.org/images/pdf/high_cost_small_loans/TB_Easypay_Puppy_Loans_Feb22.pdf;

Stop the Debt Trap Coalition, *Predatory Auto Repair Loans By TAB Bank and EasyPay Finance* (May 2022),

<https://consumerfed.org/wp-content/uploads/2022/05/Financial-Services-TAB-Bank-Auto-Repair-Loan-Report-5-11-22.pdf>;

Stop the Debt Trap Coalition, *Predatory Lenders TAB Bank and EasyPay Finance Harm Veterans and Military*

Servicemembers with Loans up to 189% APR (May 2022), <https://consumerfed.org/wp-content/uploads/2022/05/Predatory-Lenders-TAB-Bank-and-EasyPay-Finance.pdf>;

Stop the Debt Trap Coalition, *Congress Must Protect Consumers from Predatory Lending* (2021),

https://consumerfed.org/wp-content/uploads/2021/03/Rent-A-Bank-Stories_By-State-2021.pdf

correct credit reports after loans are paid in full. As is clearly elucidated through complaints to the CFPB and lawsuits, consumers are faced with deceptive practices, predatory rates, and no recourse after taking out these loans.

C. Recommendations

Interest rates are the most effective and straightforward way to protect consumers from predatory lenders. Although most states have interest rate caps, the prevalence of rent-a-bank loans illustrate the need to enact uniform, national protections. Congress should pass the Veterans and Consumers Fair Credit Act, introduced in the Senate by Senator Jack Reed (RI), Senator Chris Van Hollen (MD), and Chair Sherrod Brown (OH) with companion legislation in the House of Representatives introduced by Representatives Chuy Garcia (IL) and Glenn Grothman (WI). This legislation would extend the MLA's 36% interest rate cap to veterans, Gold Star Families, unactivated reservists, and all Americans.

Enacted in 2006, the MLA institutes an interest rate cap inclusive of add-ons and fees on consumer loans for active-duty service members and their families and has curbed predatory lending for servicemembers.¹¹² Indeed, before it took effect, 1,577 servicemembers sought help from the Navy-Marine Corps Relief Society in 2004 to pay off predatory loans, but by 2018 that number had dropped to 3.¹¹³

A national rate cap is strongly supported by the American public with polls consistently showing that 70% of voters across party lines support capping interest rates at no higher than 36%.¹¹⁴ In addition, every ballot measure held on the subject in recent years has passed with broad support, including most recently, in Nebraska where more than 80% of voters voted in favor.¹¹⁵ Ballot measures have also been passed in Colorado, Montana, and South Dakota. Further, this legislation is supported by more than 220 organizations and academics representing all 50 states and the District of Columbia.¹¹⁶

The Veterans and Consumers Fair Credit Act would:

- Prevent hidden fees and loopholes, as the 36% rate cap would include not just periodic interest but also fees and add-ons. Loopholes in TILA's annual percentage rate undermine cost transparency and embolden evasions.

¹¹² Department of Defense, *Report on the Military Lending Act and the Effects of High Interest Rates on Readiness*, (June 30, 2021), https://finred.usalearning.gov/assets/downloads/FNRED-MLA_ReportEffectsHighInterestRatesOnReadiness-May2021.pdf.

¹¹³ Navy-Marine Corps Relief Society, *Assistance provided to Active Duty and Retired Navy and Marine Corps Personnel Due to Pay Day Loan Involvement* (2018), <https://static1.squarespace.com/static/556718b2e4b02e470eb1b186/v5c7d3e0e79c70579f44162e/1551711937100/>.

¹¹⁴ CRL *Bipartisan Support for Stopping Predatory High-Interest Loans* (February 3, 2020), <https://www.responsiblelending.org/research-publication/new-poll-bipartisan-support-stopping-predatory-high-interest-loans>.

¹¹⁵ Megan Leonhardt, *CNBC*, "Nebraska becomes the latest state to cap payday loan interest rates" (Nov 4, 2020), <https://www.cbc.com/2020/11/04/nebraska-becomes-the-latest-state-to-cap-payday-loan-interest-rates.html>.

¹¹⁶ CFA, NCLC, AFR, CRL, et. al, Letter to House Financial Services Committee re "Support for Veterans and Consumers Fair Credit Act" (September 27, 2021) <https://consumerfed.org/wp-content/uploads/2021/11/Ltr-to-HFSC-in-Support-of-VCFCA-9.212.pdf>.

- Maintain low industry compliance costs by simply expanding rules enacted by the MLA that are already in effect.
- Uphold stronger state protections. 36% is a relatively high rate and is only appropriate for smaller loans and as an upper limit. Half of U.S. states have interest rate caps lower than 36%, which will not be impacted by this bill as it allows for state law that provides greater protections to consumers
- Cover all lenders, including banks, which would protect consumers from evasions like those described above.

In addition, the FDIC should stop permitting its supervised institutions to front for predatory lenders evading state interest rate limits.¹¹⁷ These schemes pose a range of legal, safety and soundness, and reputational risks to bank, including possible violation of several federal laws, including the MLA, Community Reinvestment Act (CRA), ECOA, EFTA, FDPCA, and the Fair Credit Reporting Act (FCRA). Not only are rent-a-bank schemes an abuse of the FDIC's bank charter, but they also lead to abusive lending practices by separating lender and borrower incentives. The FDIC has the tools available to end predatory rent-a-bank schemes, as it did roughly two decades ago, when it, and the other bank regulators, used its supervisory and enforcement authorities to stop banks from helping short-term payday lenders evade the law.¹¹⁸

6. Financial Inclusion

CFA is particularly concerned about products that claim to be promoting financial inclusion but, in reality, do quite the opposite. Without meaningful, holistic underwriting, affordable repayment options, and price transparency, products may do more to exacerbate financial exclusion rather than promote financial inclusion.

Many of these products use promises of limited or no credit checks which may entice consumers with thin or limited credit histories. Other products are aimed at consumers who are struggling to make ends meet or who struggle to access mainstream credit. However, failing to properly underwrite loans will simply lead to unaffordable debt for consumers.

7. Conclusion

The Consumer Federation of America appreciates the Senate Committee on Banking, Housing, and Urban Affairs for holding this hearing and the opportunity to testify. We look forward to working with the Committee to meaningfully address the potential risks that emerging fintech products pose for consumers.

¹¹⁷ NCLC, CFA, et. al, Letter to Chair Martin Gruenberg (February 4, 2022), <https://consumerfed.org/wp-content/uploads/2022/02/FDIC-rent-a-bank-letter-2022-2-4-final-corrected.pdf>

¹¹⁸ *Id.*

PREPARED STATEMENT OF PENNY LEE
CEO, FINANCIAL TECHNOLOGY ASSOCIATION
SEPTEMBER 13, 2022



Testimony of Penny Lee
Chief Executive Officer
Financial Technology Association

Before the
U.S. Senate Committee on Banking, Housing, and Urban Affairs
hearing on

“New Consumer Financial Products and the Impacts to Workers”
September 13, 2022

Thank you Chair Brown, Ranking Member Toomey, and members of the U.S. Senate Committee on Banking, Housing, and Urban Affairs for the opportunity to testify before you today on innovation in financial services that is empowering consumers with greater choice, access, and opportunity. I appreciate the chance to speak with the Committee today and work with you to support American consumers and small businesses.

I am the Chief Executive Officer of the Financial Technology Association (FTA), a non-profit trade association representing industry leaders shaping the future of finance. We champion the power of technology-centered financial services and advocate for the modernization of financial regulation to support inclusion and responsible innovation.¹

Fintech adoption has surged over the past few years. Nine in ten consumers use financial technology to manage their finances because it saves them time (93 percent) and money (78 percent), helps them make better financial decisions (73 percent), and reduces financial stress (71 percent).² Fintech innovation allows a single mom being able to buy groceries for her family without incurring an overdraft fee, a young person to manage his cash flow responsibly, or a small business owner the ability to access the capital she needs to expand operations.

These advances are coming at a critical time for the American economy. Millions remain underbanked or underserved and lack access to credit. Income and wealth inequality continues to grow, and small businesses seek to rebuild following years of uncertainty caused by the COVID-19 pandemic. Americans are more likely to report they are worse off financially than they were a year ago and express concerns about affording everyday essentials from groceries to gas, according

¹ FIN. TECH. ASS'N, www.ftassociation.org (last visited July 11, 2022). The FTA's members include Afterpay, Betterment, Block, BlueVine, Brex, Carta, Figure, Intuit, Klarna, Marqeta, MoneyLion, MX, Nium, PayPal, Plaid, Ribbit Capital, Sezzle, Stripe, Truework, Wise, Zest AI, Zilch, and Zip.

² Plaid and The Harris Poll, *The Fintech Effect: Fintech's mass adoption moment* (2021), available at <https://plaid.com/the-fintech-effect-2021-mass-adoption/>.

to polling conducted by Morning Consult on behalf of the Financial Technology Association.³ With prices rising, millions continue to struggle to make ends meet – cash flow stress makes it difficult for many Americans to cover essential costs while they might await a biweekly or even monthly paycheck.⁴

Fortunately, fintech is creating new tools for consumers to improve their financial security. I will focus my remarks today on a few key areas of fintech innovation, including those occurring in the broadly termed “buy-now, pay-later” (BNPL) and earned wage access (EWA) spaces.

Fintech Innovation: Speeding Payments, Expanding Access, and Empowering Consumers & Small Businesses

Consumer-centric innovation is transforming how we offer, access, and benefit from financial services and markets in the United States. By using technology like mobile platforms, machine learning, automation, and other modern technologies to deliver on consumer demands for financial products and services, financial technology (“fintech”) companies are improving efficiency and transparency, broadening equity, access, and inclusion, reducing costs, and increasing choice and opportunities for consumers and businesses.

Fintech solutions have emerged as critical tools to bridge physical and virtual activities as people have become increasingly accustomed to digital access. Consumers may now be less likely to exchange cash physically with employees at checkout,⁵ but more likely to move their money online as they earn, save, and invest for the long run. Large and small businesses are rapidly adjusting to these changes by enhancing their digital offerings. As we continue to emerge from the COVID-19 pandemic, the financial landscape is changing, with fintech solutions becoming part of our day-to-day economic lives.

Diverse fintech products and services provide novel, convenient, and expanded access points into the financial system for individuals, households, and small businesses, ranging from mobile money services for basic savings and payments to digital applications for long-term investing or securing credit. Already, a consumer can exchange funds, select retirement investments, get a mortgage, pay for food, or manage expenses using fintech products. Tailored products empower individuals with different needs and help drive equity in the cost and quality of available services.

More specifically, payments providers are helping facilitate millions of daily transactions of all sizes. By reducing the time and effort needed for clearing and settlement, these solutions can process payments efficiently and improve the accessibility, affordability, and speed of moving money for consumers. Traditional processes, by contrast, can be slower and more expensive, resulting in higher costs and waiting times for consumers.

³ Morning Consult, *The Impact of Buy Now Pay Later*, (September 12, 2022), available at https://www.ftassociation.org/wp-content/uploads/2022/09/FTA_Analysis_MC.pdf.

⁴ See generally, Financial Health Network, *A Financial Solutions Lab Brief on Household Cash Flow Challenges* (2015), available at <https://cfsi-innovation-files-2018.s3.amazonaws.com/wp-content/uploads/2018/09/23202632/Financial-Solutions-Lab-Brief-on-Household-Cash-Flow-Challenges1.pdf>.

⁵ CNBC, *The coronavirus pandemic has caused a surge in demand for contactless payments, accelerating the shift from cash to digital options* (Dec. 2020), available at <https://www.cnbc.com/2020/12/03/covid-19-pandemic-accelerating-the-shift-from-cash-to-digital-payments.html>.

With respect to credit access, financial technology can help solve well-documented credit gaps that have disproportionately impacted already underserved populations, including minority and immigrant groups who have limited or no traditional credit footprint. Within this context, fintech lenders and providers are using online and mobile platforms and, at times, automated underwriting and unique or nontraditional data to provide funding to businesses and individuals more streamlined and inclusively. Using these services, borrowers can request loans online and receive credit decisions faster and more consistent with their actual creditworthiness.

Buy Now, Pay Later: Advancing Consumer-Centric Innovation

With respect to BNPL, a new generation of fintech innovators are offering consumers alternative payment options that can reduce debt and alleviate budget stress. Americans, on average, pay approximately \$1,000 per year in interest on revolving credit card debt, and interest rates on all credit products are rising given the current economic environment.⁶ It is no surprise then that consumers are looking for potential alternatives and that industry is competing to serve those consumers better.

Fintech innovators in the broadly defined BNPL space offer consumers many tailored and flexible payment options, including direct payments, pay after delivery, and installment plans that typically involve equal payments over a six to eight-week post-purchase period. BNPL firms typically charge consumers zero interest or low fees for installment payment plans and perform only a soft credit pull on consumers. Additionally, BNPL firms generally charge lower late fees in the case of delinquency or default and pursue no further recourse. A consumer who defaults on a BNPL product cannot use the service again, which prevents the risk of spiraling debt or compounding fees.

BNPL solutions compete with traditional payment options to solve common consumer pain points. Surveys indicate that BNPL users prefer the payment option for a number of reasons, including that:

- They are typically lower cost, charging little or no interest or fees;
- They are transparent, helping consumers better understand – and hence control – their finances;
- They typically help users budget and, as a result, help manage cash flow;
- They are typically flexible and offer more relief when consumers find themselves unable to pay; and
- They typically result in less debt, and repayment takes place over shorter terms.

BNPL products are structured to have payment terms requiring consumers to pay for a purchase in weeks or a few months. By allowing a consumer to pay for a purchase with smaller payments over a discrete period, BNPL products can reduce cash flow stress that might otherwise present challenges for a consumer awaiting a monthly paycheck.

⁶ The Motley Fool, *Americans Pay Almost \$1,000 Per Year in Credit Card Interest* (Dec. 11, 2020), available at <https://www.fool.com/credit-cards/2020/12/11/americans-pay-almost-1000-per-year-in-credit-card/>.

It is not surprising, therefore, that a broad range of consumers prefer BNPL payment solutions as a responsible, low-risk, and low-cost option for making consumer purchases. According to a Morning Consult poll conducted on behalf of the Financial Technology Association, more than three quarters of BNPL users have a favorable opinion of the service and trust it to do the right thing for consumers. Zero- to low-interest rates were the most important factor for consumers using BNPL, with 77 percent saying it was somewhat or very important. Additionally, 94 percent of those surveyed said they understood the terms and conditions for using a BNPL payment option.⁷

Another 2020 survey of BNPL users found that more than 75 percent of consumers using a BNPL payment solution had funds available to cover the full purchase price of the target item at the time of the transaction.⁸ In fact, the majority of users had 5x the total purchase amount in their account at the time of using the BNPL payment option. The same survey found that BNPL users are predominantly female and younger, with millennials and Gen Z customers making up the vast majority of users.

A recent study by the Financial Health Network includes some additional key data points on no-fee BNPL products:⁹

- Only 4 percent of consumers said it was difficult to make payment;
- Only 4 percent were late or missed one or more payments; and
- Only 1 percent stated that they did not understand the terms and conditions of the service.

These research findings underscore a promising area of financial innovation that is helping consumers navigate their financial lives and well-being.

Notably, BNPL solutions also support America's small businesses by enhancing the customer experience, facilitating economic activity, and driving customer satisfaction. A survey of 1,051 US merchants found that offering BNPL payment solutions to customers resulted in a better customer experience, increased sales, and increased sales conversion rates.¹⁰ The benefits of BNPL are apparent regardless of merchant size, with large and small merchants seeing considerable improvement across business metrics. Another recent survey found that merchants using a particular BNPL solution enjoyed 13 percent more new customers.¹¹

Merchants have increasingly started offering multiple BNPL services along with traditional credit and debit payment options. Merchants cite customer demand, increasing total business sales, and

⁷ Morning Consult, *The Impact of Buy Now Pay Later*, (September 12, 2022), available at https://www.ftassociation.org/wp-content/uploads/2022/09/FTA_Analysis_MC.pdf

⁸ Cardify, *COVID-19 and the surge of "buy now, pay later"* (July 29, 2020), available at <https://www.cardify.ai/reports/buy-now-pay-later>.

⁹ Financial Health Network, *Buy Now, Pay Later: Implications for Financial Health* (Mar. 23, 2022), available at <https://finhealthnetwork.org/research/buy-now-pay-later-implications-for-financial-health/>

¹⁰ Zip, *Is 2021 the Year of BNPL? 6 Facts You Need to Know About This Payment Method* (June 10, 2021), available at <https://zip.co/us/merchant-hub/retail-insights/retail-insights-top-bnpl-trends-2021>

¹¹ See Accenture/Afterpay, *The Economic Impact of Buy Now, Pay Later in the US* (Sept. 2021), available at <https://afterpay-corporate.yourcreative.com.au/wp-content/uploads/2021/10/Economic-Impact-of-BNPL-in-the-US-vF.pdf>.

expanding customer choice as the key reasons for offering multiple payment solutions, including BNPL, as part of the regular offering. Given higher conversion rates and resulting increased sales from consumers' preference for BNPL, merchants offering BNPL payment solutions typically pay a fee to the BNPL provider, none of which is passed along to the consumer.

This business model means that most BNPL providers derive the vast majority of their revenue from merchants rather than consumers' fees. This is in contrast to the traditional credit model, where lenders rely on consumers revolving in debt and compounding interest for their revenue. Combined with the consumer safeguards like pausing accounts when a payment is missed, this means most BNPL companies only continue to see growth in their business if consumers are repaying on time.

BNPL Products are Subject to Robust Regulation

Importantly, BNPL products are subject to consumer protection regulations, and FTA members are committed to informing regulatory frameworks that safeguard consumers. Regardless of the BNPL offering, all BNPL products are subject to key consumer protection laws and regulations, including anti-money laundering, fair lending, credit reporting, debt collection, privacy, fair treatment of customers, and electronic fund transfers. They also are subject to similar state consumer protection laws.

Some BNPL products may not qualify as a loan when they are structured as “credit sales” or “retail installment sales,” where the legal seller of the goods and/or services agrees to accept the sales price in installment payments over time. In these instances, though, state-based frameworks govern such offerings. Other BNPL providers offer loans directly through state licensure or regulated bank partnerships, as discussed further below.

Informing Future Policy

It is an exciting time for consumers and merchants and the BNPL providers working to serve those two stakeholder groups with innovative, consumer-centric payment solutions. While there is clear evidence of the benefits, BNPL provides, FTA recognizes it is still early in the development of this space. We also believe it is crucial to remain vigilant against unscrupulous actors or products that would drive poor consumer outcomes.

We support partnering with policymakers to increase understanding of how consumers use BNPL solutions and their impact on their financial well-being. Future policy should be predicated on proper analysis of actual outcomes, including with respect to credit reporting, financial health, and consumer choice and preferences.

To this end, FTA members are engaged in active discussions with credit reporting agencies to ensure scoring models properly account for and are capable of integrating BNPL products. Given the considerable influence that credit bureaus exercise over Americans' financial health and well-being, FTA believes it is important to pursue and support the modernization of the bureaus in order to make their scoring practices and data collections efforts more transparent and inclusive, including with respect to innovations like BNPL.

Earned Wage Access (EWA): Giving Consumers Earlier Access to Their Money

Earned Wage Access (EWA) is another key area of innovation that offers consumers flexibility through on-demand and earlier access to their earned wages, helping them make timely payments on everyday expenses, avoid overdrafting their bank accounts, and manage short-term financial shocks. EWA allows an employee to access funds based on earned wages that have not yet been deposited into their account, helping them smooth out cash flow between payroll cycles, which can be as infrequent as biweekly or monthly.

It is estimated that one in five families have less than two weeks of liquid savings, which leaves them exposed to financial shocks - from unexpected medical bills to car repairs.¹² And this average does not account for racial inequities, as Black and Hispanic households are considerably more likely to face financial emergencies than white households.¹³

EWA makes it easier, more flexible, and less expensive for customers to manage their spending and avoid getting into debt because they are simply able to access wages they have already earned. A 2021 study of EWA users shows that EWA services can provide consumers with a safe alternative to avoid missing bills or sliding further into debt and found that without these services, 44 percent of consumers would be unlikely to pay their bills on time, and 38 percent would consider going into overdraft.¹⁴ The data is clear that EWA is a critical lifeline for consumers to meet their short-term liquidity needs.

There are two predominant EWA service models: the employer-based and the direct-to-consumer (D2C), both of which serve different consumer needs. With an employer-based model, individual employers partner with an EWA provider to offer their employees early access to wages. When the EWA disbursement is settled back, employers typically deduct the repayment amount directly from the employee's paycheck and settle the amount back to the EWA provider. There are multiple no-fee options for EWA, and there is sometimes a nominal fee for this service, which is sometimes covered by the employer, the employee, or a combination of the two.¹⁵

The D2C model can provide early access to income directly to any consumer who receives recurring direct deposits from an employer or other business. A broader range of customers can access D2C, including those who do not have this benefit through their employer, including gig economy workers, freelancers/contractors, and non-profit and public sector employees. Consumers may pay for this product through a monthly subscription fee, a fee per transaction, a voluntary tip amount, or a hybrid of a subscription fee plus a per-transaction or voluntary fee or tip. D2C providers commonly offer a version of the service to customers that imposes no mandatory fees.

¹² CFPB, *Insights from the Making Ends Meet Survey: Research Brief No. 2020-1* (July 2020), available at https://files.consumerfinance.gov/f/documents/cfpb_making-ends-meet_survey-results_2020-07.pdf

¹³ Ganong et al, *Wealth, Race, and Consumption Smoothing of Typical Income Shocks* (July 2020), NBER Working Paper Series, available at https://www.nber.org/system/files/working_papers/w27552/w27552.pdf

¹⁴ FTI Consulting, *Direct to Consumer Earned Wage Access User Survey Key Findings* (July 7, 2021), available at <https://www.earmin.com/assets/pdf/FTI-Earned-wage-access-memo.pdf>

¹⁵ For current models that charge the consumer a fee, [average monthly employee subscription fees range](#) from \$5 - \$10/month and individual transaction fees range from \$1 - \$5 dollars, some or all of which may be covered by the employer. Financial Health Network, *Earned Wage Access and Direct-to-Consumer Advance Usage Trends* (April 2021), available at https://efsi-innovation-files-2018.s3.amazonaws.com/wp-content/uploads/2021/04/26190749/EWA_D2C_Advance-sage_Trends_FINAL.pdf

EWA services are non-recourse and never charge interest. This means that consumers have no legal obligation to repay an advance, and providers cannot take legal action to collect payments. Customers can decide not to repay their advance at any time by revoking the authorization related to their linked bank account or changing the destination of their direct deposit.¹⁶ There is never a credit pull or credit reporting associated with this service. Failure to repay an advance does not result in interest charges or rollover payments, though it usually does limit access to additional EWA advances until the earlier advance is repaid. Importantly, since EWA products are not credit and are simply early access to an employee's *earned* wages they are not subject to TILA and state lending laws.

The Emerging EWA Regulatory Landscape

While EWA services are subject to important consumer protections, regulatory clarity is needed to resolve ambiguity that chills consumer-centric product innovation.

All EWA models are subject to general consumer protections, including state fair treatment of customers (UDAP) laws, but there is currently no specific EWA law or regulation in any state or at the federal level. Additionally, there is ambiguity in the regulatory categorization of certain EWA services, though CFPB exemptions to the payday rule, Treasury Department guidance on EWA treatment and state proposals appear to recognize that many EWA models are generally different from a traditional loan.

In 2020, the CFPB issued an Advisory Opinion stating that ‘a Covered EWA Program’ does “not involve the offering or extension of ‘credit,’” and thus, does not fall under the purview of Regulation Z, which implements the Truth In Lending Act (“TILA”). A ‘Covered EWA Program’ must, among other things, contract with the employer to offer and provide EWA services.

However, the opinion did not reference D2C models, leaving it unclear as to whether these models are subject to Reg Z. Furthermore, the issue prompted the CFPB Acting General Counsel earlier this year to recommend that the Bureau provide “greater clarity on these types of issues” across the EWA landscape.¹⁷ We agree and encourage the Bureau to engage with the industry to ensure ongoing responsible development of a range of EWA products that can serve different consumer needs and use cases.

Informing EWA Policy

FTA members are committed to EWA standards that promote consumer protection and transparency, including potential state registration requirements. However, all EWA services, regardless of the business model adopted by the provider, should be treated similarly in order to avoid anti-competitive market developments and to allow the service to be provided to the broadest possible customer segment.

¹⁶ According to the [Financial Health Network](#), the average EWA ‘unable to recoup’ rate is under 3 percent. Furthermore, the report found that the majority of EWA customers chose to pay the voluntary tip.

¹⁷ Ballard Spahr Consumer Finance Monitor, *CFPB Acting General Counsel addresses “confusion” caused by CFPB advisory opinion on earned wage access program* (Jan. 21, 2022), available at <https://www.consumerfinancemonitor.com/2022/01/21/cfpb-acting-general-counsel-addresses-confusion-caused-by-cfpb-advisory-opinion-on-earned-wage-access-program/>.

For example, according to a recent research report, “gig workers” currently represent approximately 36 percent of all workers in the U.S. economy, and by 2023, it is projected that more than half of the U.S. workforce will either be gig workers or have worked independently at some point in their career.¹⁸ EWA services should be accessible to this portion of the U.S. workforce, as well as to full-time salaried employees.

Fintech Providers and Bank Partnerships

As outlined above, financial technology companies deliver better financial services at lower costs for consumers, sometimes directly and sometimes in partnership with banks. More specifically, fintechs can offer services directly to consumers and small businesses by either complying with state licensing laws or by pursuing a banking charter. Fintechs can also choose to partner with banks to help offer services. All of these paths are subject to well-established regulatory frameworks and support healthy financial services competition that benefits consumers, small businesses, and the U.S. economy—policymakers should accordingly be supportive.

With respect to fintech-bank partnerships, 65 percent of banks and credit unions partnered with a fintech over the past three years¹⁹ and nearly nine in 10 view fintech partnerships as critical to their businesses. Partnering with fintechs helps small, mid-size, and community banks compete against large banks and better serve consumers and small businesses. Indeed, bank consolidation is at a high watermark — the top 15 banks hold over 56 percent of total deposits²⁰ — making these partnerships crucial for the success of many smaller financial institutions. During the pandemic, fintechs partnered with banks of all sizes to help small businesses struggling to stay open, accounting for the third-largest source of PPP funding,²¹ and extending capital to a significantly higher rate of Black-owned businesses than traditional banks.²²

Importantly, banks that partner with fintechs to offer credit products are subject to oversight from their banking regulators. The bank regulator can help ensure that these lending programs are fair and compliant. All applicable consumer protection laws and regulations apply to bank-fintech lending partnerships, and fintech partners are further subject to the bank regulators’ third-party vendor guidance. Additionally, the partnering bank is able to better serve its customers with leading technologies and innovations offered by the fintech. For these reasons, it is sound policy to encourage such bank-fintech partnerships and to support the banking regulators that provide effective oversight.

¹⁸ Fortnly, *Gig Economy Statistics: The New Normal in the Workplace* (Feb. 17, 2022), available at <https://fortnly.com/statistics/gig-economy-statistics/#ref>.

¹⁹ Ron Shevlin, *Bank-Fintech Partnerships Are Under-Performing: What’s Going Wrong?* (Jan. 19, 2022), available at <https://www.forbes.com/sites/ronshevlin/2022/01/19/bank-fintech-partnerships-are-under-performing-whats-going-wrong/?sh=60de477b5559a>.

²⁰ S&P Global, *Largest banks keep winning market share as deposits soar* (Sept. 21, 2020), available at <https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/largest-banks-keep-winning-market-share-as-deposits-soar-60407300>.

²¹ SBA, *Paycheck Protection Program (PPP) Report* (May 31, 2021), available at https://www.sba.gov/sites/default/files/2021-06/PPP_Report_Public_210531-508.pdf.

²² Howell et al., *Automation in Small Business Lending Can Reduce Racial Disparities: Evidence from the Paycheck Protection Program* (July 19, 2022), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3939384.

Conclusion

On behalf of FTA's 22 member companies, I appreciate the opportunity to engage with the committee today. As detailed, fintech innovation, including BNPL and EWA solutions, are driving competition and choice for consumers and small businesses that result in lower costs and better financial outcomes. Yet, we strongly believe that balanced and thoughtful regulation is key to long-term success for all involved stakeholders, including providers, consumers, and merchants utilizing new payment solutions. We look forward to helping to inform this important process.

PREPARED STATEMENT OF TODD J. ZYWICKI
GEORGE MASON UNIVERSITY FOUNDATION PROFESSOR OF LAW, GEORGE MASON
UNIVERSITY ANTONIN SCALIA SCHOOL OF LAW
SEPTEMBER 13, 2022

Chairman Brown, Ranking Member Toomey, and Members of the Committee:

I am Todd Zywicki and it is a pleasure to appear before you today to testify regarding “New Consumer Financial Products and the Impacts to Workers.” I am George Mason University Foundation Professor at Antonin Scalia Law School and Research Fellow of the Law & Economics Center. From 2020-2021 I served as the Chair of the CFPB’s Taskforce on Consumer Financial Law and from 2003-2004 I served as the Director of the Office of Policy Planning at the Federal Trade Commission. I am also co-author of *Consumer Credit and the American Economy* (Oxford 2014) and have written and spoken extensively on the impact to consumers from financial innovation, innovation, competition, and inclusion in consumer financial services products. I appear voluntarily today in my personal capacity and do not speak on behalf or represent any other party.

My testimony addresses three points:

First, the general welfare consequences to consumers from financial innovation and competition, especially with respect to traditionally underserved and excluded consumers, including both the economic benefits as well as potential consumer protection risks;

Second, the potential benefits and risks to consumers from the emergence and growth of Earned Wage Access products; and,

Third, the potential benefits and risks to consumers from the emergence and growth of “Buy Now, Pay Later” products

As will be seen, history and economic analysis demonstrate that innovation has been proven repeatedly to be a powerful mechanism to empower consumers, democratize

access to financial services on a fair and competitive basis, and, most important, to promote financial inclusion for traditionally underserved consumers, and to reduce demographic disparities in pricing and access to consumer financial services. Innovation is driving force behind greater competition, consumer choice, and empowering Americans to build a more prosperous and stable financial future. Moreover, as the recent experience of responding to the Covid pandemic made clear, innovation in consumer payments and finance is essential to resiliency in the economy to enable consumers and merchants' flexibility in responding to unexpected economic shocks.

The rapid growth in popularity of both EWA and BNPL testifies to their value in the evolving consumer financial ecosystem. Any regulatory initiatives should take great care to avoid stifling the continued growth and evolution of these products. Early in the evolution of a consumer financial product it is common for providers to experiment with different pricing, underwriting, and other business models.¹ History shows that over time as uptake of new products increases, they tend to gravitate toward more standardized terms and greater consumer value. I hasten add—this is not to say that regulators should be passive about new risks to consumers or opportunities to promote competition and innovation. It does suggest, however, that while regulators should be aggressive to prevent consumer harm, they should also be cautious about issuing premature and wide-ranging regulations that could freeze the market or entrench incumbent interests, either in these product industries or competitors, especially incumbent providers of financial services such as large banks.

¹ See Todd Zywicki, *The Economics and Regulation of Network Branded Prepaid Cards*, 65 FLA. L. REV. 1477 (2013) (describing evolution of general purpose prepaid cards toward simpler, low-fee models as a result of market forces).

The Role of Innovation in Consumer Financial Markets

Access to consumer financial products traditionally was limited to an elite group of Americans.² Bank accounts were limited to upper-income individuals and ancillary products that could provide liquidity between paychecks, such as overdraft protection, were also limited to high-income, high-status individuals.³ Similarly, access to credit cards and bank personal loans were limited to established, low-risk customers, in substantial part because unreasonably low usury ceilings made it impossible to lend to all but the most credit-worthy, higher-income customers.

Working class Americans, by contrast, relied primarily on personal finance companies, pawnbrokers, and wage access loans (essentially proto-payday loans) to obtain liquidity between paychecks and retail store credit, layaway plans, and personal finance companies to acquire consumer durables and other goods.⁴ The balkanized and segmented nature of these markets resulted from the presence of usury ceilings and other regulations that erected barriers that prevented competition across product categories, thereby dampening competition and consumer choice and increasing market power by providers.⁵ The dominant position of retail store credit and layaway in the consumer credit ecosystem in the post-War decades was primarily a reflection of the fact that residents in states with restrictive usury ceilings were unable to obtain credit cards from banks and credit unions at prevailing usury ceiling rates, whereas department stores and

² BUREAU OF CONSUMER FINANCIAL PROTECTION, TASKFORCE ON FEDERAL CONSUMER FINANCIAL LAW REPORT CHAPTER 10 (JAN. 2021)

³ See Todd J. Zywicki, *The Economics and Regulation of Bank Overdraft Protection*, 69 WASH. & LEE L. REV. 1141 (2012).

⁴ THOMAS DURKIN, GREGORY ELLIEHAUSEN, MICHAEL STATEN, AND TODD J. ZYWICKI, CONSUMER CREDIT AND THE AMERICAN ECONOMY CHAPTER 11 (2014).

⁵ *Id.*

other retailers could circumvent usury ceilings by increasing the price of the goods they sold, thereby offsetting their losses on their credit programs.⁶

More generally, this experience illustrates the “perennial problem of... enabling rationed consumers to gain access to needed credit at what is considered by [third-parties] to be a ‘reasonable’ price instead of the price established through the free interplay of supply and demand.”⁷ Ironically, providing widespread access at low prices has proven especially challenging for many consumers who are most in need of access to credit, such as young workers, immigrants, and wage-earners, who have unproven credit records, limited assets, or modest or unpredictable income flows.

Consumer credit use follows a lifecycle model. At the beginning of adulthood, consumers simultaneously have their highest demand for credit and lowest supply, aside from student loans. Consider an individual recently graduated from college. She likely needs to relocate to a new city, obtain housing, a work wardrobe, and furniture and appliances for outfitting a house or apartment, and perhaps reliable transportation (such as a car). At the same time, she is likely to have effectively no assets, savings, or other sources of liquid funds. In addition, her credit record and work history are limited and her income is the lowest it will be until she retires. As a result, she has her highest demand for credit at the same time she has her lowest supply.

As she matures and gets married, moves to a home and has children, her demand for credit increases. Children bring not only budget pressures but also budgetary unpredictability due to unexpected emergencies and the like. It is only until middle age that most Americans transition from being borrowers to being lenders (i.e., “saving”) and

⁶ Todd J. Zywicki, *The Economics of Credit Cards*, 3 CHAPMAN L. REV. 79 (2000).

⁷ CFPB TASKFORCE REPORT, *supra* at 176.

accumulate assets. At this stage of life, income and assets are highest and one's credit record is well-established at the same time that demand for credit falls as consumers begin to downsize and children begin their own lives.

Credit usage, therefore, tends to skew toward earlier in one's financial lifecycle, especially with respect to non-prime products. Access to prime credit products (such as credit cards and home equity loans) are especially limited early in adulthood. Because of the high demand for credit to acquire needed goods and services, combined with the rationed access to prime credit products, those who use non-traditional credit products tend to be younger than those who predominantly use credit cards.⁸ Moreover, most consumer durables (such as televisions, appliances, and furniture) are capital goods, thus there is great value to consumers from being able to accelerate the timing of purchases to acquire those goods and their use value rather than delaying purchase and being forced to use expensive and inconvenient alternatives instead (such as having to use a Laundromat rather than purchasing a washing machine).

History has shown the potential for innovation and competition to increase access and consumer choice for traditionally underserved consumers. Most notable, the development of national credit bureaus and particularly algorithmic-based credit scoring systems (such as FICO scores) not only increased financial inclusion and competition in consumer credit markets but also dramatically reduced disparities and discrimination in consumer lending markets by replacing archaic subjective assessments by lending officers with more objective measures of credit-worthiness.⁹ Similarly, the Supreme Court's decision in *Marquette Nat. Bank v. First Omaha Svc. Corp.* that facilitated

⁸ CONSUMER CREDIT AND THE AMERICAN ECONOMY, *supra* at Chapter 8.

⁹ CFPB TASKFORCE REPORT, *supra* at Chapter 10.

greater competition in credit card markets by enabling offerings across state lines was essential to the democratization of access of ordinary consumers to credit cards.¹⁰ In turn, by unbundling credit offering from retail purchases, *Marquette* reduced the market power of large department stores and other retailers in both retailing and credit issuance, thereby benefiting consumers through enhanced competition in both markets.¹¹

The emergence of Internet and app-based fintech products is creating an ongoing transformation in consumer financial markets today.¹² By drawing on “big data” and algorithmic underwriting models, entry by fintech providers has been shown to increase competition, increase access, reduce prices, and reduce demographic disparities in pricing in consumer credit markets.¹³ By automating underwriting and issuance functions, the fintech nature of these products allows funds to be extended at very low cost, making even very small advances (a few hundred dollars or less) economically feasible if losses can be controlled.

Against this backdrop, it is clear that EWA and BNPL products have tremendous potential to disrupt traditional consumer finance markets. Any steps toward regulation or limitation of these products should be careful to avoid inadvertent costs that might dramatically reduce the value or increase the costs to consumers.

Earned Wage Access (EWA)

Life does not happen on a two week cycle. Although many expenses are recurrent and predictable in timing and amount, such as rent or mortgages, many household

¹⁰ 439 U.S. 299 (1978).

¹¹ See Zywicki, *Economics of Credit Cards*, *supra*.

¹² See the extended discussion in CFPB TASKFORCE REPORT, *supra* at Chapters 9 and 10.

¹³ *Id.* at Chapter 10.

expenses are less predictable. Yet wages are typically paid on biweekly, semimonthly, or monthly pay periods which creates a lag between the time that workers earn wages and the time they are actually received. This timing lag can be exacerbated by any delay in the clearance of a paycheck once deposited. If a consumer needs cash during this latency period between the time wages are earned and paid, they may often be forced to turn to expensive alternatives such as payday loans or bank overdraft protection, or be unable to make desired and potentially necessary purchases because of lack of liquid funds.

EAW programs have emerged as a fintech-based solution to this problem of accessing liquidity during the lag between the time wages are earned and actually paid.¹⁴ This delay can be especially burdensome for new hires when the length of time between the first day of employment and first paycheck may be especially long.¹⁵ This delay can lead some consumers to turn to short-term small-dollar products such as payday loans to meet short-term liquidity needs between paychecks.¹⁶ EWA programs that allow consumers early and convenient access to their wages that have been earned but not yet disbursed.

Although it is possible that employers could pay wages on a more frequent basis, such as daily, it appears there remain certain technological, economic, and financial challenges to doing so, especially for smaller businesses. As a result, employers have typically partnered with third-parties to provide this service to employees. To date it is estimated that about 10 percent of companies have adopted EWA programs, especially larger employers with hourly or gig-economy workers such as Walmart, McDonald's,

¹⁴ See Bureau of Consumer Financial Protection, Advisory Opinion: Truth in Lending (Regulation Z); Earned Wage Access programs (Nov. 30, 2020).

¹⁵ *Id.* at 2.

¹⁶ *Id.* 2-3 (citing research by Financial Health Network).

and Uber.¹⁷ That fraction is expected to continue to grow rapidly in the short run. Some surveys report that as much as 80 percent of employees would prefer more frequent payments, whether weekly or even daily as doing so enables them to budget better and reduces financial anxiety.¹⁸

Early EWA programs featured a variety of business models and fee structures.¹⁹ Most of them were funded by some combination of fees assessed on employers and employees. Sometimes employers would cover employee fees in part or whole. Today, however, EWA programs are moving toward a pricing model of free employee access to wages with an ACH bank transfer or bank direct deposit, with a modest fee for acquiring funds by some alternative means.²⁰ Many EWA programs involve transfer of funds to a debit card issued by a partner bank (such as a Visa or MasterCard-branded card) and for which the EWA provider earns revenues through interchange fees when the consumer spends the money on the card which supports the program. The program itself is primarily funded by the interchange fee revenue when the consumer uses the card.²¹

Risk of loss is low on these programs due to the fact that providers are advancing against funds already earned but not yet paid. While it is possible that an employer could have a later claim for recoupment against these funds, recoupment efforts are rare and even more rare are efforts by the provider to try to recoup those losses against employees.

¹⁷ See Elena Whisler, *How Earned Wage Access Will Help Employers Through the Big Quit*, THE CLEARING HOUSE (Aug. 5, 2022), available in https://www.theclearinghouse.org/payment-systems/articles/2022/08/insights_08-2022#:~:text=Today%2C%2010%20percent%20of%20companies,adopt%20earned%20wage%20access%20programs.

¹⁸ *Id.*

¹⁹ *Id.* at 3.

²⁰ See, e.g., PAYACTIV.COM, <https://www.payactiv.com/program-pricing/> (listing EWA Disbursement Type Fees).

²¹ See Devina Khanna, and Arjun Kaushal, *Earned Wage Access and Direct-to-Consumer Advance Usage Trends* at Appendix, FINANCIAL HEALTH NETWORK (Apr. 2021) (listing fee structure for consumers from various EWA programs).

Moreover, most programs only allow the employee to draw only a portion of the funds earned but not yet paid (typically 50%), with the remainder paid at the end of the pay cycle. This holdback of wages reduces the risk of loss or need for subsequent recoupment. Still, this practice of limiting the amount of funds available appears to be rationalized primarily as a paternalistic limit on the ability of workers to gain access to their money, not to protect the financial solvency of the program, and I hope that eventually these limits will be reconsidered in the future consistent with responsible management of risk.

A study by the Financial Health Network this spring estimated that advances were successfully recouped at least 97% of the time.²² Advances are relatively small in amount—according to one study the average was around \$120.²³

A mismatch in the timing between when wages are received and when bills are due is generally recognized as a contributing factor to consumer use of bank overdraft protection or high-cost small-dollar loans, such as payday loans. Although some consumers use these products as short-term credit products, a significant number also appear to use them for liquidity to bridge timing gaps between the receipt of wages and when financial obligations are due.²⁴ EWA can serve as much lower cost and more convenient means for accessing liquidity than traditional payday loans. According to a survey by the Mercator Group conducted for one company, more than half of its customers previously used a payday lender but after they started using EWA, 69% of that group no longer used payday lenders and another 23% used payday loans less frequently

²² See Devina Khanna, and Arjun Kaushal, *Earned Wage Access and Direct-to-Consumer Advance Usage Trends* 11 FINANCIAL HEALTH NETWORK (Apr. 2021).

²³ *Id.*

²⁴ See CFPB, *Earned Wage Access* Advisory opinion, *supra* at 2.

or for smaller loans than previous.²⁵ Similarly, prior to uptake of EWA, 81% of them experienced NSF fees but afterwards 59% rarely or never overdrafted and another 31% overdrafted less frequently or for smaller amounts than previously.²⁶ Ninety-one percent also said that were less likely to pay bills late after gaining access to EWA than previously. As a result of access to EWA, employees stated they did not have to borrow as frequently from friends and family, pay late fees to a biller, incur NSF fees, pay for expenses with a credit card, or use a payday lender. In addition, by enabling them to reduce their reliance on these expensive alternatives, 77% of customers said that more frequent and convenient access to their wages enabled them save more money.

According to the same survey, 78% of users of the EWA product said they used the early access to funds to pay for groceries, 64% for utility bills, 54% for transportation and car insurance, and 53% for unexpected expenses. In light of high rates of inflation and energy costs in the economy today, it seems likely that many more consumers will be facing increasing budgetary pressure for expenses such as groceries, utilities, gasoline, and other necessities.

A study by AiteNovarica reported similar findings about the benefits to workers from access to EWA.²⁷ Before using DailyPay's EWA product, 57% of employees reported having paid a bill late, 49% borrowed from friends or family, 39% overdrew their bank account, 21% took out a payday loan, and 21% make a loan payment late or not at all. Overall, about 14% of survey respondents both overdrew their account *and* used a payday loan while about one-third did one or the other. Over 95% of employees reported that after using DailyPay they overdrew their accounts less often, used payday

²⁵ See Mercator Advisory Group, *Customer Perceived Cost Savings: Study Sponsored by DailyPay*.

²⁶ *Id.*

²⁷ See AiteNovarica, *DailyPay Use and Outcomes: A Summary of Survey Findings* (Aug. 2021).

loans and borrowing from friends and family less frequently, and made fewer late bill payments than before. Research from other EWA providers confirms these findings.²⁸

These industry surveys comport with the observations and experience of those of us who have studied the short-term lending market for years. It is clear that at least some use of small-dollar credit is for liquidity purposes to cover the lag between earning wages and receiving them. As a result, it is hardly surprising that providing employees with access to their money on a more frequent basis at low or zero cost could substantially reduce their reliance on these expensive alternatives and enable them to better manage their financial affairs.

In this sense, arguments over whether EWA products should be classified as “credit” transactions and subjected to TILA disclosures and the like completely misses the point, especially now that an increasing number of EWA providers offer fee-free advances for basic access to one’s money, with a modest fee if the consumer seeks particular services such as faster access or a transfer to a different account than then provider-issued card. The rapid uptake of EWA where it has become available is a testament to the need it fills in the consumer finance ecosystem and regulators should be cautious about issuing regulations that could freeze the future development of this product. EWA is an ingenious solution to the longstanding difficulty of designing a product that can meet the liquidity needs of wage-earners at low cost and easy convenience.

Buy Now Pay Later (BNPL)

²⁸ See Instant, *Wages and Wellbeing: Analyzing the Impact of Same-day Pay* (April 2022).

BNPL is another emergent fintech product that represents an update on traditional methods of consumer finance, such as installment loans, credit cards, and layaway plans. The use of installment loans to enable purchases of consumer durables, such as appliances, electronics, and furniture, dates to at least the late-19th century in the United States. Because many of these products are in the nature of capital goods, there is substantial value to consumers from being able to change the time of purchase so as to acquire the goods and use them while paying for them. The emergence of credit cards and their widespread adoption beginning in the second half of the 20th Century made it possible for consumers to extend their use of credit from financing consumer durables to general consumption purposes.

BNPL emerged several years ago as a fintech solution to the traditional model of installment sales to finance consumer durables but has grown rapidly. According to one survey of consumer behavior during the Covid pandemic, the most common types of purchases made by consumers using BNPL were for consumer durables such as clothing, electronics, furniture, appliances, and housewares.²⁹ Today, BNPL increasingly is available for other consumer purchases beyond consumer durables, such as gasoline. The rapid growth in online shopping in response to the forced business closures associated with the Covid pandemic accelerated merchant and consumer uptake of BNPL.

The BNPL market is fragmented and many of the operations are outside the traditional banking system. Moreover, BNPL transactions are not included within the

²⁹ C+R Research, *Buy Now, Pay Later Statistics and User Habits (2021)*, available at <https://www.crrresearch.com/blog/buy-now-pay-later-statistics>. BNPL originally had disproportionate uptake by younger women, as BNPL focused on developing partnerships with female focused ecommerce brands. See CARDIFY, COVID-19 AND THE SURGE OF “BUY NOW, PAY LATER,” CARDIFY.COM (July 29, 2020), available in <https://www.cardify.ai/reports/buy-now-pay-later>. It is not clear whether this is still the case and the growing usage of BNPL for electronics purchases, for example, suggests that this disparity in use by sex may no longer be the case.

credit reporting system, thus there is minimal transparency to determine the exact size of the industry or the demographic characteristics of its users. The CFPB has announced that it is collecting information on the industry, which should provide useful information to better understand the structure of the industry and its operation.

It appears, however, that BNPL users are young and BNPL is often used as an alternative to credit cards, either by choice (BNPL is often less-expensive for most consumers than revolving credit card credit) or because the consumer either has no credit card or is nearly maxxed out and thus lacks available free credit lines.

A typical BNPL transactions if a point-of-sale loan that allows consumers to pay for online or in-store retail purchases over a set period, typically four payments every two weeks (1/4 at the time of purchase then additional payments every two weeks). Although modeled after traditional retail installment loans, most BNPL transactions are interest free consumers and are funded by the merchant through a discount rate of approximately 3-6% (higher than the cost of a typical credit card). This short-term no-interest financing is the predominant business model—according to one report, 70% of BNPL users are for short-term financing with no interest, 21% are for six months or less with no interest, and only 11% are for longer than six months with interest.³⁰ If the consumer makes payments on time, therefore, she usually incurs no fee or other costs from using BNPL, unlike a credit card for which the consumer will pay a finance charge if the balance is not paid in full at the end of the cycle.

³⁰ See Hannah Gdaman, Meghan Greene, Necati Celik, *Buy Now, Pay Later: Implications for Financial Health: A FinHealth Spend Product Spotlight* at 4, Fig. 1 (March 2022).

Estimates vary as to how many households use BNPL. Some surveys have suggested that as much as 50% of consumers have used a BNPL service.³¹ Although possible, this figure seems implausibly high to me. I suspect a more accurate estimate is around 10% of American households used BNPL in the past year.³² According to one estimate, the number of BNPL users has grown by more than 300 percent per years since 2018, reaching 45 million active users in 2021 and today represents about 2 percent of U.S. online retail sales.³³

BNPL has proven to be especially attractive to consumers who are otherwise underserved by the mainstream financial system, such as younger, lower-income, and credit-impaired consumers. Younger and less financially healthy households are more likely to use BNPL, particularly millennials and Generation Z, who either lack access to credit cards or prefer the interest-free nature of BNPL and its more simple and transparent terms relative to credit cards.³⁴ Households in weaker financial condition are also more likely to use BNPL than financially healthy households.³⁵ BNPL users are also almost twice as likely to report having subprime credit scores and 77% who have credit cards say they have carried a balance on their credit cards over the past year.

For all households, but especially households with impaired or thin credit, BNPL provides an inexpensive option to finance purchases without a credit card or without

³¹ See, e.g., Maurie Backman and Jack Caporal, *Study: Buy Now, Pay Later Services Grow in Popularity*, THE ASCENT, FOOL.COM (July 18, 2022), available in <https://www.fool.com/the-ascend/research/buy-now-pay-later-statistics/>.

³² See Gdalmán, *et al.*, *supra* at 4.

³³ See Julian Alcazar and Terri Bradford, *The Appeal and Proliferation of Buy Now, Pay Later: Consumer and Merchant Perspectives*, FED. RES. BANK OF KANSAS CITY PAYMENT SYSTEMS RESEARCH BRIEFING (Nov. 10, 2021), available in <https://www.kansascityfed.org/research/payments-system-research-briefings/the-appeal-and-proliferation-of-buy-now-pay-later-consumer-and-merchant-perspectives/>.

³⁴ See Gdalmán, *et al.*, *supra* at 5.

³⁵ *Id.*

having to pay interest on revolving credit card balances.³⁶ Most BNPL purchases are modest in size—according to one survey, users of the short-term, no-interest mode reported owing an average of \$330 across all BNPL purchases at the time of the survey.³⁷ As with traditional credit cards or consumer credit, using BNPL enables these consumers to make purchases they otherwise would have been unable to make or would have been required to use a credit card for (which could be more expensive). Moreover, according to research by the Financial Health Network, 99% of BNPL users stated that they understood the terms and conditions associated with using the product.³⁸

According to one research report, the most common reason consumers give for using BNPL is “to make checkout easier.” This group is made up of middle income people with incomes between \$40,000-\$80,000 and skew toward millennial-aged consumers who see BNPL as similar to payment platforms and digital wallet apps.³⁹ Higher income consumers often use BNPL to avoid taking on debt, especially credit card debt, and tend to be slightly older.

BNPL is particularly attractive to younger (Gen Z and millennial), lower-income, and credit-impaired consumers because they do not run a full credit check before extending credit. Most BNPL providers only run a soft credit check for interest-free installment loans thus are available to those with limited or impaired credit histories. Like traditional personal finance companies, the lender’s decision whether to extend credit rests primarily on the lender’s relationship with the customer rather than general credit record. Rather than issuing a line of credit based on the applicant’s general credit record,

³⁶ Backman and Caporal, *supra*.

³⁷ Gdalmán, *supra* at 7.

³⁸ *Id.* 7.

³⁹ CARDIFY, CONVENIENCE, DEBT, AND NOVELTY: ANALYZING BNPL CONSUMER DATA (Sept. 8, 2021), available in <https://www.cardify.ai/reports/bnpl-trend-report>.

BNPL lenders will typically start a consumer with a small line of approved credit and raise the available amount over time based on the consumer's demand. Failure to pay can result in denial of access to future credit from that provider. Thus, although losses are possible, they are usually modest in amount for each non-performing borrower.

Beyond denial of future BNPL applications, the consequences of late payments and default are unclear and merit further study. Some lenders charge a fee for late payments but those are usually relatively small in amount and vary by lender. Although BNPL providers do not check your credit score before extending credit, some may report missed or late payments to credit bureaus, which could result in harm to a borrower's credit record. Some reports suggest that some BNPL providers send delinquent debt to collections, but it is unclear how often and under which conditions this is the case. I have found no evidence in my research that BNPL providers bring collections actions in court. If the economy tilts toward recession in coming months, it is likely that delinquencies and defaults will increase, which could create incentives for providers to take a more aggressive stance toward collections efforts—this is a development that bears monitoring by the CFPB and other consumer protection officials.

The rapid rise and development of BNPL, especially among younger consumers, reflects both the potential of fintech to serve traditionally underserved consumers as well as increasing the potential for a greater variety of products that can serve consumers better. There appears to be a potential dramatic shift ongoing in the way in which younger consumers use financial services.⁴⁰ In particular, after many decades of a tendency

⁴⁰ I emphasize the term "potential" because it is not clear whether the current changes reflect a permanent change in the trajectory of use of consumer financial services or a temporary change that will lead Millennials and Generation Z back toward more traditional models of banking as they mature. See CFPB TASKFORCE REPORT, *supra* at Chapter 12.

towards “bundling” of financial services into one-stop shopping of integrated large banks, younger consumers increasingly are consuming financial services in a disaggregated fashion, using a variety of apps and platforms for payments, borrowing, investing, and the like. Younger consumers have also expressed some concern over financial privacy and distrust of the traditional banking system. As a result, the limited and disaggregated nature of BNPL products may be appealing to their lifestyle and privacy concerns.⁴¹

Younger consumers also appear to be financially “maturing” later than earlier generations of consumers. The availability of these alternatives to the traditional banking system has made it less necessary for them to open and maintain a traditional bank account than in the past. Bank accounts have become much more expensive in terms of fees and elevated restrictions, such as higher minimum monthly balances to avoid fees, have increased the cost and reduced access to traditional bank accounts. The primary driver behind these increased costs and reduced access to bank accounts has been a variety of expensive regulations enacted since the financial crisis, such as Dodd-Frank and the Durbin Amendment that placed price controls on debit card interchange fees. Other regulations, notably the Credit CARD Act of 2009, restricted access to credit cards for younger consumers, which in turn has delayed their building of a credit record. In turn, this has perpetually delayed the timing of their access to credit cards and other mainstream financial products.⁴²

Of greater relevance will be developments in the BNPL market as interest rates continue to increase and the economy tips toward recession in over coming months. These developments will impact both consumer demand and provider supply of BNPL.

⁴¹ See CFPB TASKFORCE REPORT, *supra* at Chapter 12.

⁴² CFPB TASKFORCE REPORT, *supra* at Chapter 10.

BNPL usage exploded during the government-imposed pandemic shutdowns as merchants scrambled to build greater capabilities for online shopping. BNPL usage growth has slowed since the economy reopened.

If the economy dips into recession and interest rates continue to rise, however, BNPL usage could increase by both merchants and consumers. As interest rates increase and household budgets become tighter, consumers can be expected to be increasingly attracted to the interest-free terms of BNPL as an alternative to higher interest rates on credit cards. Increasing prices of goods such as gasoline, energy, and groceries will likely lead to greater usage by consumers for these non-durable purchases. At the same time, recessionary conditions likely will lead to a tightening of access to credit cards and other consumer credit, especially among non-prime consumers, leading many consumers to turn to BNPL as an alternative. How consumers and providers respond to recessionary and high interest rate conditions will test BNPL's business model.

To date, most of the concerns that have been expressed about BNPL are largely theoretical and unsupported by tangible empirical evidence. It appears the primary concern about BNPL is that certain consumers will spend "too much" if they are given the opportunity to use BNPL too freely or will be unable to properly manage their finances. This vague concern has limited empirical support behind it to date. As with EWA and all other non-prime financial products, the most relevant question is what alternatives these consumers would be left with if they are unable to access BNPL as a result of regulations that end up restricting access to these products. Under conditions of high interest rates, high inflation, and recessionary economic conditions, BNPL could

turn out to be a crucial lifeline for consumers and smaller merchants to provide important resiliency during the coming challenging economic conditions.

Conclusion

Thank you for your time and the opportunity to appear before you today and I am happy to take any questions you may have.

PREPARED STATEMENT OF DAVID H. SELIGMAN
EXECUTIVE DIRECTOR, TOWARDS JUSTICE
SEPTEMBER 13, 2022

Chairman Brown, Ranking Member Toomey, Members:

Thank you for the opportunity to testify before you today about employer-driven debt, an increasingly prevalent and multi-faceted problem affecting workers in a variety of sectors, up and down the wage scale.

I am an attorney and the Executive Director of Towards Justice. Towards Justice is a non-profit legal organization that uses impact litigation, policy advocacy, and collaboration with workers and workers' organizations to build worker power and advance economic justice. We are deeply concerned about the growth of employer-driven debt, which corporations far too often use to abuse their power and keep workers trapped in their jobs. We have litigated several cases involving employer-driven debt, in which our clients assert claims under a range of protections, including anti-trafficking laws, labor standards laws, and consumer protection laws.

I am here today to testify about the harms of employer-driven debt and to urge interagency collaboration, regulatory oversight, and vigorous enforcement of consumer and worker protection laws to address those harms.

Introduction:

We should understand employer-driven debt broadly to capture the many ways in which workers become consumers of credit as part of their employment relationship. Sometimes the relevant creditor is a third party—like companies that provide short-term loans to workers, in the form of purported early access to their wages. Sometimes the creditor is the employer itself—like companies that require workers to agree to pay back the costs of training if they leave their jobs before the end of a contractual commitment period, as in training repayment agreement provisions (TRAPs).¹

Employer-driven debt is an increasingly pervasive problem. Its growth is a function, among other things, of employers using new strategies to undermine worker bargaining power in the face of a tight labor market; increased scrutiny of non-compete and other direct restraints on worker mobility; increased misclassification of workers as independent contractors; and the growth of new financial products that facilitate the extension of credit in the employment relationship.

Some frame employer-driven debt as an innovation of employers and the financial services sector that we should celebrate—and seemingly insulate from any regulatory oversight. They suggest that these forms of debt are essential to workers who need access to credit to make ends meet, training to advance their careers, or the costs of starting-up a job.

But workers' difficulties meeting financial demands and advancing professionally do not arise because they lack access to credit. They arise because far too many workers still do not earn

¹ See generally Student Loan Borrower Protection Center, *Trapped at Work, How Big Business Uses Student Debt to Restrict Worker Mobility*, June 2022, https://protectborrowers.org/wp-content/uploads/2022/07/Trapped-at-Work_Final.pdf.

a living wage or even a predictable schedule that allows them to meet their basic financial obligations. And far too many employers seek to shift onto their workers their own costs while undermining their workers' bargaining power by making it costly for them to seek out jobs where they might be treated better or paid more.

In other words, employer-driven debt does not solve problems created by our labor market; it obscures problems like insufficient wages and unfair scheduling. Not only that, it exacerbates those problems, by driving down workers' wages and undermining worker bargaining power through the impediments it creates to worker mobility.

The Dangers Posed by Employer-Driven Debt:

Employer-driven debt can cause several overlapping injuries to workers and to the labor market. More than one of these dangers may arise in a single case, but they each present distinct categories of harm that highlight the importance of interagency collaboration, regulatory oversight, and enforcement of worker and consumer protection laws.

This Committee should pay attention in particular to the following three dangers of employer-driven debt: (1) employer-driven debt can restrain worker mobility, undermining worker bargaining power; (2) employer-driven debt can shift employers' costs onto workers; and (3) employer-driven debt can obscure low wages and poor working conditions. As with so many other abuses in our marketplace, these challenges disproportionately affect immigrants and people of color.

Employer-driven debt can undermine worker mobility:

Perhaps the most concerning feature of employer-driven debt is how corporate employers use it to restrain worker mobility. The threat of going to work elsewhere is essential to a worker's leverage to obtain better working conditions and higher wages. Workers trapped in their jobs may be stuck with low pay, dangerous conditions, abusive treatment, or work that does not allow them to advance professionally. Even workers who do not intend to leave their jobs benefit from the theoretical risk that if their wages are too low, they will find other work. For this reason, there is strong evidence that non-compete agreements suppress wages for the workers covered by them.² Far too many workers in a variety of industries experience similar restraints on their ability to find employment elsewhere because they are bound to their employer through the threat of debt collection if they leave their jobs before the end of a contractual commitment period.

The amount of the debt and its purported justifications can vary. On one extreme, some immigrant healthcare workers are bound to their employment with staffing agencies through so-called "breach fees" or "liquidated damages" provisions of between \$20,000 and \$50,000 if they

² Alexander J.S. Colvin and Heidi Shierholz, *Noncompete agreements: Ubiquitous, harmful to wages and to competition, and part of a growing trend of employers requiring workers to sign away their rights*, Economic Policy Institute, December 10, 2019, <https://www.epi.org/publication/noncompete-agreements/>.

leave before the end of their contract.³ Those fees, which are often many times a worker's monthly wages, purportedly are justified by a range of costs including bringing the worker into the country, training, and the supposed damages that follow from the worker leaving their job earlier. In these contexts, employer-driven debt may amount to involuntary servitude and the threat of collecting on that debt a threat of "serious harm" designed to coerce workers into continuing to work for their employer in violation of federal and state trafficking laws.⁴

Employer-driven debt ties workers to their employment in a variety of other ways. TRAPs, for example, require a worker to repay the costs of training, sometimes provided by the employer and sometimes provided by a third party, if the worker leaves their job before the end of their contract term, which is often several years. These debts often far exceed the reasonable value of the training to the worker.⁵ And in many cases, the training at issue is not for the worker's benefit at all but is really standard training provided for the employer's benefit.⁶ By threatening workers with debts that can amount to several months of rent, TRAPs often force workers to make the impossible choice between putting up with low wages, bad working conditions, or even abusive treatment or risk aggressive debt collection, marks on their credit, and financial ruin.

Employer-driven debt shifts the costs of doing business onto workers:

Especially when accompanied by misclassification, employer-driven debt may shift onto workers an employer's business costs. Misclassification schemes may promise workers the "American dream" of independence or small business ownership in exchange for the worker paying for costs the employer should bear by financing those costs, sometimes through a third party and sometimes through the employer itself.

Consider, for example, cleaning companies that sell their low-wage cleaning workers on purchasing a purported cleaning franchise and the tools and equipment necessary to provide cleaning services.⁷ These purported franchisors may then finance those costs for their misclassified workers. The worker satisfies payment obligations through deductions off their pay.⁸ In many cases, workers in these industries take home less than minimum wage at the end of the week, while the company minimizes its own financial risk and overhead. In some situations,

³ Josh Eidelson, *Nurses Who Faced Lawsuits for Quitting are Fighting Back*, BusinessWeek, Feb. 2, 2022, <https://www.bloomberg.com/news/features/2022-02-02/underpaid-contract-nurses-who-faced-fines-lawsuits-for-quitting-fight-back#xj4y7vzkg>.

⁴ See, e.g., *Paguirigan v. Prompt Nursing Emp. Agency LLC*, 286 F. Supp. 3d 430 (E.D.N.Y. 2017). Towards Justice is counsel in cases involving similar practices.

⁵ See, e.g., *Montoya v. CRST Expedited, Inc.*, 404 F. Supp. 3d 364, 398–99 (D. Mass. 2019)

⁶ See Taylor Telford, *PetSmart offered free training. But it saddled employees with debt.*, Wash. Post, Aug. 4, 2022, <https://www.washingtonpost.com/business/2022/08/04/petsmart-dog-grooming-training-labor-lawsuit/>.

⁷ See, e.g., *Roman v. Jan-Pro Franchising Int'l, Inc.*, No. C 16-05961 WHA, 2022 WL 3046758, at *17 (N.D. Cal. Aug. 2, 2022)

⁸ See, e.g., *Castillo v. Cleannet USA, Inc.*, Cal. Super. Ct., 17-562611 (2017), Compl., <https://legalaidatwork.org/wp-content/uploads/2017/11/Optimize-Complaint.pdf>.

as the worker faces mounting financial pressures, the employer will continue extending loans to the worker, which the worker must continue to work off. The result is a harsh and predatory debt spiral, coupled with a form of modern indentured servitude.⁹

Employer-driven debt obscures low wages and poor working conditions:

Employers often use employer-driven debt to obscure low wages and poor working conditions. One example of this pattern arises when an employer suggests that debt does not have a cost if the employer forgives it after a worker completes a commitment term with the employer. Consider, for example, PetSmart's alleged suggestion that its "groomer training" is free, when in fact PetSmart imposes debt obligations on the workers who receive that training and forgives the debt, allegedly, only after the employee has worked for the company for two years.¹⁰ Debt of this form often has substantial costs; most importantly, because there is a financial penalty for leaving the employment, the employer has more bargaining power than it would otherwise have and may thus be able to pay its workers less because it is costly for them to find higher paying work elsewhere.

Earned wage access products may also be deceptive. Creditors may fail to disclose that short-term loans of this sort have extraordinary effective interest rates. Additionally, the existence of these and similar products can help to obscure from workers the fact that the employer's wages are too low or their scheduling practices too unfair and unpredictable to ensure that workers have sufficient and predictable income to allow them to consistently make ends meet.

Consider, for example, hotel employees in Philadelphia, who complained that their employer's scheduling practices made it difficult for them to earn consistent income without getting a second job. Many of those workers became reliant on so-called "mini loans" extended by their employee credit union, which allowed them quick access to cash when their weekly wages were not enough to pay rent or put food on the table. The problem was that the lender allegedly failed to disclose the true costs of that credit, which included various fees and charges. This meant, according to the workers who filed suit, that the employer and its related creditor were, together, able to offer workers unpredictable schedules and low wages while giving them access to enough credit to keep them in their jobs, without disclosing the true costs of that credit to workers.¹¹

This pattern may be common, especially in the service and retail sectors. Workers in this sector often struggle with unpredictable and variable schedules that can make it difficult for

⁹ *Id.*

¹⁰ See note 6, *supra*. Towards Justice is counsel in the case described in this article.

¹¹ See *Marriott workers' lawsuit says inconsistent schedules and credit union loans are a predatory mix*, Phila. Inquirer, Feb. 18, 2019, <https://www.inquirer.com/news/marriott-credit-union-lawsuit-payday-loans-20190218.html>.

workers to plan ahead or earn consistent wages across workweeks.¹² An employer is much more likely able to get away with providing workers with twenty hours of work in some weeks and forty hours in other weeks, when the worker can *borrow* funds that between paychecks. In these cases, the employer uses early wage access as a subsidy for its unfair scheduling practices and low wages.

Applicable Legal Protections and the Importance of Inter-Agency Collaboration

The various problems posed by employer-driven debt to workers in this country implicate several interrelated legal protections and federal agencies' jurisdictions. In many cases, several legal protections may be implicated by the same type of practice—misclassified workers, trapped in their jobs by start-up costs financed through their employer may be protected by labor standards laws, credit discrimination laws, and laws prohibiting trafficking and unfair methods of competition.

In other cases, workers may be protected by either labor standards laws or consumer protection laws. If a TRAP seeks to recoup costs for training that was principally for employee's "personal, family, or household use,"¹³ then the employer is effectively operating a for-profit school and extending private student loans subject to federal disclosure requirements.¹⁴ If the training is for the employer's benefit, then the employer is seeking a kickback against wages, potentially in violation of federal and state wage-and-hour laws.¹⁵

Because of the interrelated legal and policy issues implicated by employer-driven debt, the federal government should take bold action, across agencies, to address the serious and multifaceted harms employer-driven debt causes workers.

Application of the consumer protection laws:

Employers and other creditors in the employer-driven debt space may not appreciate the potential applicability of consumer protection laws to their activities. But just because a company is operating as an employer does not mean that they are not also extending credit to their workers, and just because they think they may have successfully avoided application of the employment laws to their activities—for example by classifying their workers as independent contractors—does not mean that consumer financial protection laws do not apply when they extend credit to their workers. In many cases, employer-driven debt is a consumer credit product, and it implicates traditional consumer protection laws in a variety of ways.

¹² Stephanie Wykstra, *The movement to make workers' schedules more humane*, Vox, Nov. 15, 2019, <https://www.vox.com/future-perfect/2019/10/15/20910297/fair-workweek-laws-unpredictable-scheduling-retail-restaurants>.

¹³ 15 U.S.C. § 1602(i).

¹⁴ 15 U.S.C. § 1638(e).

¹⁵ *See, e.g.*, 29 CFR § 531.35 ("The wage requirements of the [FLSA] will not be met where the employee "kicks-back" directly or indirectly to the employer or to another person for the employer's benefit the whole or part of the wage delivered to the employee.").

Where it misrepresents or obscures the costs of credit, employer-driven debt implicates protections against deceptive practices and the Truth in Lending Act (TILA).¹⁶ Earned wage access programs, for example, may appear to provide early access to wages, but they are a short-term loan, whose costs are sometimes not disclosed to workers.¹⁷ In some cases, the effective interest rates on these loans may exceed state interest rate caps. At the very least, TILA applies to these products and requires disclosure of the finance charges, fees, and costs of the credit to workers. That minimum level of transparency helps to ensure that workers appreciate that these programs may not be a free benefit, but rather that their employer may be shifting onto them the costs of credit to compensate for low wages and inconsistent scheduling.

Consumer protections against unfair, deceptive, and abusive acts and practices in the provision of consumer financial products may also be implicated by credit products extended by an employer.¹⁸ Where, for example, TRAPs are extended to workers to cover training costs that are principally for “personal, family, or household use,” disclosure requirements apply to require that employers disclose the true costs of those products. In many cases, TRAPs are private educational loans and employers should be subject to the special disclosure requirements applicable to other private student loan providers. Additionally, it may be deceptive to describe as “free” TRAPs or other forms of employer-driven debt that is forgiven if the worker completes a commitment period to the employer. Finally, it may be unfair or abusive for employers to use TRAPs or other consumer credit products in the employment relationship to undermine worker mobility, especially where the debt far exceeds the reasonable value of training or other benefits provided to workers.

The collection of employer-driven debt by employers or third parties also implicates the Fair Debt Collection Practices Act (FDCPA)¹⁹ and the Fair Credit Reporting Act (FCRA).²⁰ In particular, where an underlying debt is illegal and unenforceable, for example because it violates wage and hour laws or even federal trafficking laws, as described below, the FCRA may provide protections for workers against having those debts reported to credit reporting agencies,²¹ and the FDCPA protects against aggressive debt collection by collection agencies. These protections are especially important in the employer-driven debt context because employers and third parties frequently use the threat of credit reporting and debt collection to keep workers trapped in their jobs.

¹⁶ 15 U.S.C. § 1601, *et seq.*

¹⁷ Letter from Ninety-Six Consumer, Labor, Civil Rights, Legal Services, Faith, Community and Financial Organizations and Academics Urging CFPB to Reverse Earned Wage Access Actions, Oct. 12, 2021, https://www.nclc.org/images/pdf/banking_and_payment_systems/fintech/CFPB-EWA-letter-coalition-FINAL2.pdf.

¹⁸ *See, e.g.*, 12 U.S.C. § 5536(a)(1)(B).

¹⁹ 15 U.S.C. § 1692, *et seq.*

²⁰ 15 U.S.C. § 1681, *et seq.*

²¹ 15 U.S.C. § 1681s-2(a)(1)(A) (“A person shall not furnish any information relating to a consumer to any consumer reporting agency if the person knows or has reasonable cause to believe that the information is inaccurate.”).

We appreciate that the Consumer Financial Protection Bureau is looking closely at this problem.²² It is critical that consumer protection agencies, especially the CFPB, bring their enforcement, regulatory, and supervision authority to bear on this problem.

Application of wage-and-hour protections alongside consumer protections:

Employer-driven debt also implicates the labor standards laws. Most importantly, where employers seek to recover or do in fact recover costs that are principally for their own benefit, then the employer-driven debt agreement is an agreement to kickback wages to the employer, which could bring a worker's wages below minimum wage.²³ If the debt obligation becomes due at the end of a worker's employment, then the kickback is measured only against the last week of wages, meaning that in most contexts, the kickback will be a minimum wage violation.²⁴ But even where the debt does not bring the worker's wages below minimum wage, the kickback may be a violation of state wage payment laws.

A kickback of this sort occurs in the TRAP context where the training does not provide a meaningful transferable benefit to the employee, like licensing or certification that the employee could use to obtain future employment, but rather is training provided by the employer that is principally for the employer's benefit. It could also occur where the employer purports to lend the worker the costs of hiring or recruiting the worker or other costs the employer should bear and then forgives those costs only if the worker remains in the employment for an entire contract period. We should understand those arrangements as being no different from an employer requiring the employee to pay back their wages if the employment relationship terminates.

Kickbacks of this sort are especially common in the misclassification context, where employers may finance for workers start-up costs or the costs of tools or equipment, like the costs of a truck or franchise fees.²⁵ Framing these kickbacks as business loans may help the employer sell predatory and misclassified work as the opportunity to be an entrepreneur. But these purported loans are a kickback against wages whether the employer collects them through deductions off wages or through a debt obligation that accelerates if employment is terminated within a certain period.

²² CFPB Launches Inquiry into Practices that Leave Workers Indebted to Employers, June 9, 2022, <https://www.consumerfinance.gov/about-us/newsroom/cfpb-launches-inquiry-into-practices-that-leave-workers-indebted-to-employers/>.

²³ 29 C.F.R. § 531.35; see also *Montoya v. CRST Expedited, Inc.*, 404 F. Supp. 3d 364 (D. Mass. 2019) (employer prohibited from deducting loan repayment).

for training costs to the extent they brought the wages below the minimum wage).
²⁴ See *Arriaga v. Fla. Pac. Farms, L.L.C.*, 305 F.3d 1228, 1237 (11th Cir. 2002), *Chao v. Bauerly*, 2005 WL 1923716, at *4 (D. Minn. Aug. 11, 2005) (“Thus, to the extent that the training reimbursement agreement withheld minimum wages for the hours worked by the employees during their final pay period, the agreement violates the FLSA and is unenforceable.”).

²⁵ See, e.g., *Villalpando v. Exel Direct Inc.*, No. 12-CV-04137-JCS, 2015 WL 5179486, at *15 (N.D. Cal. Sept. 3, 2015).

To address these problems, it is critical that agencies like the United States Department of Labor (DOL) vigorously enforce wage-and-hour protections in the employer-driven debt context. Because of the proliferation of misclassification arrangements, insulated by forced arbitration, it is often difficult for workers to address these challenges through private enforcement. Additionally, because workers cannot seek injunctive relief under the FLSA,²⁶ it may be difficult for them to bring private suit to protect themselves from employer-driven debts until the employer has recovered those debts. Until that point, some courts may conclude that suits seeking to invalidate the debt are seeking injunctive relief. This reasoning would be incorrect, as a minimum wage violation occurs as soon as the minimum wage is not paid “free and clear,” and damages for “unpaid minimum wages” in this context could include debt cancellation.²⁷ But the DOL could sidestep these arguments and provide protection to workers whose employers keep them trapped in jobs through the employer’s mere *threat* of collecting the debt, which is an illegal kickback against wages.

It is also critical that agencies like the CFPB and DOL coordinate to ensure that employer-driven debt does not slip between the cracks of agency authority. This is especially true because in many cases, one agency’s authority will pick up where another’s ends. For example, an employer arguing that its TRAP is not covered by TILA because the training is not for “personal, family, or household use” is acknowledging that its TRAP seeks to recover a kickback against wages because it seeks to recoup training costs that were primarily for the employer’s benefit. Alternatively, an employer may argue that its TRAP seeks to recoup the costs of training that is principally for the benefit of the employee—by, for example, giving them meaningful opportunities for professional advancement. But by arguing that the training is not principally for the employer’s benefit—but is instead training principally for the benefit of the employee—the employer is effectively admitting to operating a for-profit school and extending private student loans to its workers to cover the costs of that schooling. In that context, the consumer protection laws should apply just as they would to any private institution of higher learning and student loan lender.

In other words, in many cases, employers cannot insulate their abuses of power from all agencies at the same time, but agency coordination, especially between the DOL and CFPB, is essential to ensure that no worker falls between the cracks.

Application of anti-discrimination protections:

Employer-driven debt disproportionately harms immigrants and people of color. Members of these groups are disproportionately excluded from our most hard-fought labor standards protections,²⁸ left behind by our labor market, and burdened by a generational wealth

²⁶ See, e.g., *Roberg v. Henry Phipps Est.*, 156 F.2d 958, 963 (2d Cir. 1946).

²⁷ See, e.g., *Stein v. HHGREGG, Inc.*, 873 F.3d 523, 534 (6th Cir. 2017)

²⁸ Rebecca Dixon, NELP Executive Director, *From Excluded to Essential: Tracing the Racist Exclusion of Farmworkers, Domestic Workers, and Tipped Workers from the Fair Labor Standards Act*, Hearing before the U.S. House of Representatives Committee Education and Labor Workforce Protections Subcommittee, May 3, 2021, <https://edlabor.house.gov/imo/media/doc/DixonRebeccaTestimony050321.pdf>.

gap.²⁹ As a consequence, they may be especially vulnerable to employers that sell their workers on the false promise of the American dream, autonomy, and entrepreneurial opportunities in exchange for entering into a debt to their employer. Very often these jobs do not provide meaningful opportunities for professional advancement or financial mobility. Instead, they can come with crippling debt that can keep workers trapped—perhaps the purported franchise fees imposed on a misclassified worker and financed by the employer or the costs of recruitment to the United States, loaned to the worker and forgiven only if the worker remains in the employment for a several-year-long commitment period.

Where employers target immigrants and people of color with these schemes, they are engaging in a form of reverse red lining that implicates the anti-discrimination laws. Agencies like the CFPB and the Equal Employment Opportunity Commission (EEOC) should collaborate to investigate these practices. Importantly, because the CFPB’s authority to enforce the Equal Credit Opportunity Act (ECOA) is not limited by the requirement that the underlying credit be for “personal or household use,”³⁰ it has the authority to address employer-driven debt even in contexts where the employer frames the credit relationship as a small business loan and even where the worker may in fact be an independent contractor under federal employment laws.

Application of competition laws:

Employer-driven debt also implicates competition laws in various ways, especially insofar as it is designed to keep workers trapped in their jobs.

In recent years, regulators and lawmakers have curtailed the use of non-compete agreements and other restraints on worker mobility that arise in the contractual relationship between the employer and worker. In July 2021, President Biden issued an executive order calling upon the Federal Trade Commission (FTC) to “curtail the unfair use of non-compete clauses and other clauses and agreements that may unfairly limit worker mobility.”³¹ Around the same time, Oregon,³² Nevada,³³ and Washington D.C.³⁴ imposed new state-level restrictions on non-compete agreements, following in the footsteps of California, North Dakota, Oklahoma, Maine, New Hampshire, Rhode Island, Washington, Hawaii, New Hampshire, Illinois, and, more

²⁹ Aditya Aladangady and Akila Forde, *Wealth Inequality and the Racial Wealth Gap*, Feds Notes, October 22, 2021, <https://www.federalreserve.gov/econres/notes/feds-notes/wealth-inequality-and-the-racial-wealth-gap-20211022.html>.

³⁰ Official Interpretation of Reg. B, 12 C.F.R. pt. 1002, supp. I, § 1002.1(a)-1. *See also id.* at § 1002.2(j)-1. *See, e.g., Bartlett v. Bank of Am.*, 2014 WL 3773711, at *4 (D. Md. July 29, 2014), *aff’d*, 603 Fed. Appx. 209 (4th Cir. 2015).

³¹ <https://www.whitehouse.gov/briefing-room/presidential-actions/2021/07/09/exo21kjuecutive-order-on-promoting-competition-in-the-american-economy/>

³² <https://olis.oregonlegislature.gov/liz/2021R1/Downloads/MeasureDocument/SB169/Enrolled>

³³ <https://www.leg.state.nv.us/App/NELIS/REL/81st2021/Bill/7300/Text>

³⁴ <https://www.dcregs.dc.gov/Common/NoticeDetail.aspx?NoticeId=N102934>

recently, Maryland,³⁵ Virginia,³⁶ and Colorado,³⁷ all of which ban the use of non-compete agreements, particularly for low-wage workers. The Department of Justice (DOJ) has also highlighted how non-compete agreements may implicate the antitrust laws, especially where they are imposed by employers with substantial market power.³⁸

Employer-driven debt, when tied to the termination of the employment relationship, should be treated like any other contractual restraint on worker mobility. This is especially true because there is evidence that some employers have migrated away from explicit restraints on worker mobility—like non-compete agreements—and have shifted to using employer-driven debt like TRAPs to impede workers’ ability to leverage the threat of exit for higher wages and better working conditions.³⁹ Where employer-driven debt agreements undermine worker bargaining power in these ways, they function like non-compete agreements, and should be subject to the antitrust laws, laws regarding unfair competition, and state regulation of non-compete agreements.

Anti-trafficking and peonage laws:

Finally, the law does not permit employers or others to provide a work opportunity in exchange for a worker’s promise to indenture themselves to their employer through debt. These sorts of work arrangements harken back to Nineteenth Century peonage used to subjugate former slaves,⁴⁰ and they are precisely the kind of exploitation that our anti-trafficking and peonage laws were designed to prohibit. Where the threat to collect a debt is a threat of “serious harm,” it is a violation of federal prohibitions against forced labor.⁴¹

While most employer-driven debt may not rise to the level of trafficking, it is critical for federal agencies, including the CFPB, the DOL, the FTC, and the DOJ to coordinate to identify the most predatory and exploitative work arrangements and address them under laws prohibiting forced labor and debt peonage.

Conclusion:

Traditionally, consumer, labor standards, and competition laws have been viewed as separate spheres that address separate problems and provide separate solutions. But employer-driven debt blurs these lines to the point of meaninglessness. The result is that enforcement and

³⁵ <https://law.lis.virginia.gov/vacode/title40.1/chapter3/section40.1-28.7:8/>

³⁶ <https://mgaleg.maryland.gov/mgaweb/laws/StatuteText?article=gle§ion=3-716&enactments=false>

³⁷ <https://leg.colorado.gov/bills/hb22-1317>

³⁸ Stmt. of Interest, *Beck v. Pickert Medical Grp.*, No. CV21-02092, Nev. Second Judicial District Court (Feb. 25, 2022).

³⁹ See note 1, *supra*, at 12.

⁴⁰ *Tobias Barrington Wolff*, *The Thirteenth Amendment and Slavery in the Global Economy*, 102 *Colum. L. Rev.* 973, 982 (2002).

⁴¹ 18 U.S.C. § 1589(a)(2).

oversight often fall through the cracks, as corporations take advantage of a lack of coordination among advocates, enforcers, and regulators working in different spheres.

Of course, workers in this country do not care if their problems are properly characterized as employment problems, consumer problems, competition law problems or problems falling under any other possible label. What matters is that government is there to police abuses of corporate power that make it hard for everyday working people in this country to make ends meet through work. We appreciate this Committee's attention to this important issue.

**RESPONSES TO WRITTEN QUESTIONS OF SENATOR WARNOCK
FROM RACHEL GITTLEMAN**

Q.1. Ms. Gittleman, in your testimony you mentioned that one of the tactics used by these lenders is disguising fees as tips. Are these tips truly voluntary? If not, do you believe it's deceptive to refer to these fees as "tips"?

A.1. "Tips" are not truly voluntary due to a variety of techniques companies use to make it difficult not to tip, and these tactics make tips inherently deceptive and deceitful. Companies utilize a variety of strategies to make it difficult not to tip or to make the consumer feel compelled to tip. Strategies include adding a default tip that must be removed each time; or denying or reducing future credit if a consumer fails to tip enough. Even without manipulative strategies, consumers are more likely to feel compelled to tip for fear of being treated differently or denied access in the future.

Further, tips are not often included in product marketing and promotions or even in information about fees in the product terms and conditions, which leads consumers to believe that these products are free, especially when promoted with promises of no interest or monthly fees. By labeling a finance charge as a tip, providers are relying on the obligation that consumers often feel when tipping another human after completion of a service, like in restaurants or other service industries. Some providers further encourage that feeling by labeling tips as "lender appreciation" tips. Other providers make disingenuous statements about how tips support a "community" or will help other "users make ends meet" or deceitfully labeling tips as "donations."

However, these tips do not go to another human being and are not in appreciation of a service—instead, they go to the company's bottom line. Further, tips are added to the repayment amount before the transaction is fully completed and tips are paid via the authorization to debit a user's account per user contracts. Consumers do not tip after the service has taken place in appreciation for good service which might make them more voluntary.

Finally, the label does not change the inherent nature of these charges; it simply allows providers to claim otherwise. Tips increase the cost of credit, can add up quickly, and consumers have no way to compare that cost with other forms of credit. The "tip" model takes advantage of consumers' lack of awareness of how tips add up, especially since small tips can add up to a high cost over time nearing payday loan pricing and thus, can make it easier for consumers to get sucked into the cycle of debt. The pricing may also look cheap to consumers on its surface because it's portrayed as a flat fee rather than APR. It is marketed in ways to hide the true cost or dismiss the APR as irrelevant due to the shorter loan cycle. But these high charges for smaller loans result in exorbitantly high APRs, regardless of whether they are portrayed to consumers in that way. Regardless of the label, advances that charge tips are balloon payment loans, with repayment on the next deposit or other equally short schedule. Like other balloon payment loans, they can lead to dependency or a cycle of reborrowing, and high rates of overdraft and NSF fees.

Q.2. Do you believe there is an environment where forms of credit such as Buy Now, Pay Later or Earned Wage Advances can be beneficial to consumers? Do you have any regulatory suggestions that could encourage innovation and safeguard consumers at the same time?

A.2. These products may help certain consumers manage their finances but are not risk free. At their core, each of these products are still credit products that should be covered by basic consumer protections at the State and Federal level, including interest rate limits, underwriting for ability-to-repay, cost transparency, dispute rights, and fair lending laws.

BNPL providers are within the scope of the Truth in Lending Act (TILA) and should be treated as “Card Issuers” subject to all credit card protections codified by TILA. The CFPB should clarify that BNPL products are credit cards, subject to the fee disclosures, ability-to-repay requirements, reasonable and proportional penalty fees, chargeback protections, dispute rights, standard statement requirements, and appropriate and helpful credit reporting practices that apply to credit cards. These protections would ensure that consumers have the same basic protections they do when using other forms of credit.

Beyond the CARD Act, Federal and State regulators should provide necessary oversight and supervision of BNPL providers, ensuring that they are not engaging in unlawful discrimination or unfair, deceptive or abusive acts or practices, and are abiding by other consumer protection laws including the Military Lending Act (MLA), the Electronic Funds Transfer Act (EFTA), and the Fair Debt Collection Practices Act (FDCPA). State regulators should require lenders to abide by applicable licensing and usury laws. State and Federal regulators should make sure that lenders are not charging unfair fees or shifting into an abusive fee model. Finally State and Federal regulators should consider collecting data on these programs to better understand the risks associated with them.

As for Earned Wage Advances (EWAs), we hope that the CFPB clarify that EWAs provide credit to consumers. Although free EWA products may fall outside of the scope of TILA, those that charge fees are within the scope. Access and expedite fees charged by EWA providers are finance charges that should be presented to consumers in terms of an annual percentage rate. State regulators should also regulate these fee-based earned wage access products as credit covered by all State credit regulations and laws, including usury laws.

Regardless of structure, a product where a third-party advances funds to a consumer ahead of the consumer’s payday and is then repaid in some fashion out of the paycheck is a loan. We are greatly concerned about the potential harms of viewing these fee-based earned wage access products as something other than credit, leading to evasion of consumer protection and fair lending laws. Treating EWA products as credit does not mean these products should not exist. It merely means that consumers have the same basic consumer protections and disclosures as they do when using other forms of credit—a concept that is likely already expected. Moreover, failing to regulate them as credit will invite payday lenders

and other high-cost lenders to enter this market, which could lead to even more exploitive rates and practices.

In addition, the CFPB should address inflated expedite fees either through TILA or through its authority to protect consumers from Unfair, Deceptive and Abusive Acts and Practices (UDAAP). We also recommend that the CFPB further supervise these fee-based EWA providers and conduct research on the impact of EWA programs, especially on low-income consumers and their ability to build wealth and achieve financial security.

Fintech providers that purport to lend earned wages and seek access to a consumer's bank account, but are not employer integrated, are essentially a payday loan and should be supervised and regulated as such.

**RESPONSES TO WRITTEN QUESTIONS OF SENATOR DAINES
FROM PENNY LEE**

Q.1. According to the Federal Reserve Bank of Atlanta, “In open banking, a consumer authorizes a financial services company with which they have a relationship to allow designated third parties to access their financial data.”¹

What potential requirements could be imposed on third parties to simultaneously require the secure use of consumer data while also promoting new open-banking partnerships?

A.1. FTA believes that any open banking rule should establish strong guidelines for consumer transparency and control, including that consumers be aware of all parties involved in data sharing and have ownership over the data they are sharing, with whom, and for what duration. FTA further supports standards-development in service of consumer rights by establishing baseline principles and expectations that those standards must meet.

In particular, we strongly support the development and use of secure application programming interfaces (APIs) as the primary mechanism for consumers to share financial data with designated third parties, with screen scraping serving as a fall back option when a financial institution does not have an API, which is most common for smaller institutions.

Q.2. What agency would likely regulate nonbank data aggregator fintech firms?

A.2. While the Consumer Financial Protection Bureau is likely best placed to regulate a nonbank data aggregator fintech firm—subject to the public notice and comment rulemaking processes—in light of 1033 of the Dodd-Frank Act; currently, through bank-fintech partnerships and other arrangements, fintechs including data aggregators have been subjected to some level of oversight by Federal banking agencies.

Q.3. Small businesses are struggling to hire in a historically tight labor market. Data from the Bureau of Labor Statistics shows that there are nearly two jobs for every unemployed worker. According to a recent survey by the U.S. Chamber of commerce, 56 percent

¹ Lott, David. “American Consumers May Soon Have Open Banking”. Federal Reserve Bank of Atlanta, <https://www.atlantafed.org/blogs/take-on-payments/2022/06/06/american-consumers-may-soon-have-open-banking>.

of small businesses say they are concerned about recruiting and 57 percent are concerned about employee retention. As a result, small businesses are increasingly turning to offering access to Early and Earned Wage Access programs in order for them to remain competitive in their market.

Can you describe how this new pay frequency is being used by employers?

A.3. As we know, life doesn't happen in 2-week cycles. An employer providing an Earned Wage Access (EWA) program gives employees the ability to access their already earned wages before their next scheduled paycheck. Without EWA services 44 percent of EWA consumers would be unlikely to pay their bills on time, and 38 percent would consider going into overdraft. EWA makes it easier, more flexible, and less expensive for customers to manage their spending and avoid getting into debt because they are simply able to access wages they have already earned.

There are two predominant EWA service models—the employer-based and the direct-to-consumer (D2C), both serve different consumer needs. With an employer-based model, individual employers partner with an EWA provider to offer their employees early access to wages. When the EWA disbursement is settled back, employers typically deduct the repayment amount directly from the employee's paycheck and settle the amount back to the EWA provider. There are multiple no-fee options for EWA, and there is sometimes a nominal fee for this service, which may be covered by the employer, the employee, or a combination of the two.

The D2C model provides early access to income directly to any consumer who receives recurring direct deposits from an employer or other business. A broader range of customers can access D2C, including those who do not have this benefit through their employer, including gig economy workers, freelancers, contractors, and nonprofit and public sector employees. Consumers may pay for this product through a monthly subscription fee, a fee per transaction, a voluntary tip amount, or a hybrid of a subscription fee plus a per-transaction or voluntary fee or tip.

Q.4. Consumers benefit from having access to a wide range of financial services. Many of the innovative products in the market today, such as Early Wage Access and Earned Wage Access, are often coupled with other innovative solutions, such as credit builders or budgeting tools that help build out an individual's complete financial health. This holistic and innovative approach to financial health is often omitted when talking about short-term credit or financing products.

Can you speak to some of these innovative solutions the industry is offering in addition to short-term financing solutions?

A.4. Fintech solutions have emerged as critical tools to bridge physical and virtual activities as people have become increasingly accustomed to digital access. Diverse fintech products and services provide novel, convenient, and expanded access points into the financial system for individuals, households, and small businesses, ranging from mobile money services for basic savings and payments to digital applications for long-term investing or securing credit. Already, a consumer can exchange funds, select retirement invest-

ments, get a mortgage, pay for food, or manage expenses using fintech products. Tailored products empower individuals with different needs and help drive equity in the cost and quality of available services. More specifically, payments providers are helping facilitate millions of daily transactions of all sizes. By reducing the time and effort needed for clearing and settlement, these solutions can process payments efficiently and improve the accessibility, affordability, and speed of moving money for consumers.

With respect to credit access, financial technology can help solve well-documented credit gaps that have disproportionately impacted already underserved populations, including minority and immigrant groups who have limited or no traditional credit footprint. Within this context, fintech lenders and providers are using online and mobile platforms and, at times, automated underwriting and unique or nontraditional data to provide funding to businesses and individuals more streamlined and inclusively. Using these services, borrowers can request loans online and receive credit decisions faster and more consistent with their actual creditworthiness.

Finally, fintechs can also be leveraged to address other issues. For example, using fintech services as collaboration platforms, businesses can partner with payment card issuers to improve authorization rates and reduce fraud. In addition, as consumer trends continue to shift toward digital payments, including new options like buy now pay later, ACH payments, and digital wallets, businesses are deploying fraud prevention strategies earlier in the customer journey. Patterns and information are identified before the transaction period to preempt fraud and facilitate efficient transactions.

**RESPONSES TO WRITTEN QUESTIONS OF SENATOR DAINES
FROM TODD J. ZYWICKI**

Q.1. Deloitte’s case study into Open Banking found that regulatory responses to changes in the fintech environment are often too slow and may suffer ineffectiveness as a consequence.¹ To solve this, lawmakers and others involved in the rulemaking process should increase the use of strategic guidance over proper regulation. Guidance can be issued and updated faster than regulation, in turn allowing them to respond to the rapidly growing fintech market.

Therefore, how do you see the role of regulation in fintech markets compared to guidance? How can guidance be a more effective tool for regulators, consumers, and fintech firms than regulation?

A.1. Response not received in time for publication.

**RESPONSES TO WRITTEN QUESTIONS OF SENATOR SINEMA
FROM DAVID H. SELIGMAN**

Q.1. Your testimony criticizes earned wage access products primarily on the basis that effective interest rate terms and applicable fees are not adequately disclosed to workers. In your opinion, what

¹Strachan, David. “Open Banking: Disruption Is Afoot for Regulators as Well as Banks”. Deloitte, 10 Nov. 2017, <https://www2.deloitte.com/uk/en/pages/financial-services/articles/open-banking-disruption-afoot-for-regulators-and-banks.html>.

would the timing and contents of an effective disclosure look like for a worker who utilizes an earned wage access product?

A.1. Thank you, Senator Sinema. Earned Wage Access (EWA) products are credit, and they are covered by consumer protections like the Truth in Lending Act. It is critical that EWA creditors provide clear disclosure of the costs of the credit transaction, which would include fees and effective interest rates. Pursuant to TILA, those disclosures must be made “before the consummation of the transaction.” Reg. Z 1026.1(b). In the case of EWA products, this would have to happen before any worker agrees to enter into an Earned Wage Access transaction.

Q.2. Are there additional concerns you have with earned wage access products beyond disclosure of fees and effective interest rates?

A.2. Yes. EWA products carry risks that may not be resolved through disclosures alone.

First, EWAs carry the risk of a cycle of debt and reborrowing. Taking an advance on the next paycheck when the current paycheck is not sufficient to meet basic financial needs could put a worker into a further financial hole, requiring them to take on more debt. Evidence suggests that workers who rely on EWA products typically use them between 12 and 120 times per year.¹ That reflects a concerning pattern in which workers using EWA products are more likely than other borrowers to end up in a cycle of debt. In these cases, workers are often not using those products to access liquidity for new expenses, but rather to fill gaps created by the repayment of a prior loan. The pattern is even more concerning because a debt cycle of EWA credit may impede workers from leaving their employment because they feel like they need to keep working off a loan they have already taken out, even if a different employer would pay them more or treat them better.

Second, EWA products may obscure low wages or unfair and unpredictable scheduling practices that prevent workers from earning consistent, predictable, and living wages.

Third, while some EWAs do not include fees, many others do, either directly or through a “tips” model. In either case, the costs of these short-term loans can be extraordinary.

Far too many workers have difficulty making ends meet. The costs of basic needs like housing, childcare, and health care are too high, and workers’ wages are not keeping pace with corporate profits and prices. We must work to address that fundamental problem. Access to short-term credit products like EWAs is not a solution. While some EWA products may provide safe forms of credit, these products must be regulated and scrutinized, with an eye toward the specific risks they pose to workers and the labor market.

¹ Letter from National Consumer Law Center & Center for Responsible Lending to Consumer Financial Protection Bureau, RE: Concern about prior leadership’s finding that certain financial earned wage access products are not “credit” TILA, October 12, 2021, at 5, available at <https://www.nclc.org/wp-content/uploads/2022/10/EWA-letter-to-CFPB-Oct-4-2021.pdf>.

**RESPONSES TO WRITTEN QUESTIONS OF SENATOR WARNOCK
FROM DAVID H. SELIGMAN**

Q.1. In which industries are you seeing the largest growth in terms of the use of training repayment agreement provisions (TRAPs)?

A.1. Thank you, Senator Warnock. We are seeing an explosion of various forms of employer-driven debt, including training repayment agreement provisions. TRAPs are a subset of a broader category of employer-driven debt that includes breach fees and liquidated damages provisions that purport to require workers to pay extraordinary debts if they leave their job before the end of their contractual work period.¹ There is little data on the use of employer-driven debt across our labor market—in part because we see so much recent growth of employer-driven debt—but anecdotally, we are seeing the most growth in health care, especially among nurses. We also see TRAPs in contracts with service workers, truckers, teachers, and many others.

Q.2. I agree with Chairman Brown investing in employee training is something employers should do, not employees. Especially as we've seen historic gains in wages over the past year, this practice feels like a way for corporations to pass off costs to their workers and indirectly cut their hard-earned wages. Are there data that show the real wage employees are receiving when accounting for debt incurred and other costs from TRAPs?

A.2. Thank you. I appreciate the question. As I testified, in many cases, TRAPs seek to recoup the costs of training that was principally for the benefit of the employer—much of this training does not provide the worker with a transferable license or degree. Employers that hold such debts over the heads of their workers during their employment are making wage payments that are in effect conditioned on the worker staying in their job. If they leave their job, they must kickback costs to the employer that the employer may not require the worker to bear. Employers using TRAPs in this way may not be paying minimum wages to those workers “free and clear” as required by Federal law CFR §531.35.

There is not much data regarding the extent to which TRAPs and other forms of employer-driven debt may be suppressing worker wages. You are correct that such wage suppression includes the actual costs of the TRAP, which many workers pay back to their employer when they leave their jobs. But the recent growth in TRAPs makes it difficult to ascertain the amount of wages workers are kicking back to their employer. That is not, however, the only measure of harm to workers and wages. For many workers, TRAPs function like noncompete agreements that prevent them from seeking out other employment, robbing them of their bargaining power and suppressing their wages, even when they are not seeking out other employment. Recent data suggests that noncompete agreements and other impediments to worker mobility can cause sub-

¹ See, e.g., Josh Eidelson, “Nurses Who Faced Lawsuits for Quitting Are Fighting Back”, *Businessweek*, Feb. 2, 2022, <https://www.bloomberg.com/news/features/2022-02-02/underpaid-contract-nurses-who-faced-fines-lawsuits-for-quitting-fight-back>.

stantial wage suppression.² That data should also be considered in evaluating the harms of TRAPs. But of course, even that research does not capture the individualized harm that many workers experience when they are trapped in jobs that may be unsafe, unfair, or even abusive.

**RESPONSES TO WRITTEN QUESTIONS OF SENATOR DAINES
FROM DAVID H. SELIGMAN**

Q.1. Following up on Senator Toomey’s opening remarks, while Democrats are labeling bank-fintech partnerships as “rent-a-bank” schemes and rescinding OCC rules that removed regulatory uncertainty, consumers are failing to ask for these new, burdensome regulations. Instead, 99 percent of consumers stated that they understood the terms and conditions of their BNPL and less than 4 percent of consumers using a BNPL incurred a late fee.¹

How could overturning the OCC rule lead to diminished access to credit for low-income borrowers?

A.1. Thank you, Senator Daines. The OCC does not have oversight over third-party BNPL lenders, and as far as I am aware, there are no OCC rules that directly regulate BNPL providers. The OCC provides critical regulation, supervision, and oversight of national banks, Federal savings associations, and Federal branches of foreign banks. The OCC ensures that these entities follow applicable laws and regulations, treat consumer fairly and equitably, and operate in a safe and sound manner.

Q.2. How do burdensome regulatory structures interfere with the compounding rate of financial innovation?

A.2. Everyone benefits from responsible regulations. Markets benefit because regulation leads to fewer predatory actors. Regulated entities benefit because there are clear expectations about what conduct is legal, which facilitates safer innovation and fairer competition. Finally, consumers benefit because they are protected from unfair and predatory financial products and can have more faith in the integrity of the financial services marketplace. Credit products, like those discussed at the hearing, need to be regulated and overseen from origination through the life cycle of the credit.

² See, e.g., Brian Callaci, Sergio Pinto, Marshall Steinbaum, and Matt Walsh, “The Effect of No-poaching Restrictions on Worker Earnings in Franchised Industries” (2022).

¹ Lee, Penny, “New Consumer Financial Products and the Impacts to Workers”. Financial Technology Association, FTA, <https://drive.google.com/file/d/0B1agOsrt-GBtSUVIVkt2MR1U3c/view>.

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD
STATEMENT SUBMITTED BY BRIANA GORDLEY



United States Senate Committee on Banking, Housing, and Urban Affairs Listening Session

September 7 @ 10:30 am

<https://www.banking.senate.gov/hearings/member-and-staff-listening-session>

Introduction

Good morning. Thank you for giving me the opportunity to provide virtual testimony for the U.S. Senate Committee on Banking, Housing, and Urban Affairs Listening Session. My name is Briana Gordley and I'm a policy analyst at Texas Appleseed, a nonprofit that works to change unjust laws and policies that prevent Texans from realizing their full potential. However, I am not here to speak on behalf of my organization, but for myself and my own personal experiences with "Buy now, pay later" (BNPL) products.

Personal Use of BNPL Products

In 2016, I was an 18 year-old full-time college freshman who also worked full-time to make ends meet. I typically didn't have additional money to spend on myself once my bills were paid, but during one of the few times that I did, I went to the mall and shopped at a store called "Forever 21," which is when I saw my first advertisement for BNPL products. Shortly after, I downloaded the *Afterpay* app and became a regular user. I was first approved for \$100, and as my ability to repay the full amount increased, so did my limit.

Afterpay was easy to navigate and was initially very manageable to track my payments, making it even more compelling to continue its use. Once I made my final purchase on *Afterpay*, I was introduced to another BNPL product - *Klarna*. Because I had just reached my maximum payment on *Afterpay*, I saw a *Klarna* advertisement on the *Afterpay* website and decided to download the app and see what it had to offer. What I wasn't expecting to see on *Klarna* was the vast amount of new stores that weren't offered on *Afterpay*, such as Apple, Best Buy, and even Amazon. As a first-time *Klarna* user, I was approved for a maximum purchase amount of \$250. After successfully making my first purchase, my approval amount increased to a whopping \$1,000. As alarming as this initially was, I thought at the time, "why would these different BNPL platforms approve me for such high amounts if they didn't believe I could repay them?" They believed in my ability to repay my debt, and so I trusted in that as well.

Once I reached my maximum purchase amount on *Klarna*, I moved over to another BNPL product called *Quadpay* and immediately was approved for \$500 dollars, which I quickly took advantage of. Ultimately, my two *Quadpay* purchases were sent to collections as I was already struggling to manage 4 large *Klarna* payments. Over the 1.5 year course of using BNPL products, I spent a total of \$1,525, was charged \$116 in non-sufficient funds fees and overdraft fees, and had my final three BNPL purchases, totaling \$385 dollars, sent to collections. I was struggling to pay off a little over \$1100 during my final year of using BNPL products, which seemed like an impossible feat. I was drowning in debt. I sold a lot of my personal items to try and pay off the debt, and at one point, I even considered taking out a payday loan to make up for the rest. But ultimately, I confided in my parents about the debt I had incurred, and they were able to pay it off. I was then able to set up a manageable payment plan with my parents with the promise that I would never use these products again. With BNPL products now being reported to some of the credit reporting agencies, I can only imagine how catastrophic using these products could have been for my financial health and future at just 18 years-old.

Today, as a policy analyst advocating for consumer protection and regulation, I can better recognize the potential predatory nature of financial products. But at just 18, I didn't care to "better understand" BNPL products. I saw an opportunity to finally enter into a space I felt was unattainable for me at the time. BNPL products not only take advantage of knowing this about their customers, but they capitalize on this heavy desire by approving outrageously high payment amounts across multiple BNPL platforms for low-income people with little-to-no foundation and inconsistency in approval amounts across platforms.

Moving forward

So many people are living paycheck to paycheck, often unable to meet their most basic needs, let alone have the funds for recreational spending, and so I understand why BNPL products are such an attractive product - they definitely were to me. At first, using only one BNPL platform with one purchase at a time, my payments were trackable and manageable, making repayment feasible. However, as the number of purchases across more BNPL platforms increased, my ability to track and manage my payments decreased. I was spiraling downhill quickly.

As I look back on my experience, I see now that what would have made a difference would have been to have a clear understanding of what I owed and when I owed it. I understand and believe in personal accountability and responsibility for the choices I made, but accountability and responsibility should be a two-way street between consumers and businesses, and I urge the committee to consider how new and evolving fintech products, such as BNPL, can, whether intentional or not, harm vulnerable consumers, and trap them in debt before their lives have even started. Thank you again for this opportunity.

STATEMENT SUBMITTED BY BREANN SCALLY

Members of the Committee and Chairperson Brown,

Thank you so much for the opportunity to share my story with you. My name is BreAnn Scally. I'm 25 years old, and I live in Northern California. Ever since I was a little kid, it's been my dream to open up a cage-free animal shelter, where I can take care of animals who have been abandoned or mistreated.

I'm here to talk to you about how my former employer—PetSmart—kept me trapped in a miserable job by holding a debt over my head for their "grooming academy," a training program that barely taught me anything and whose only long-term impact on my career is a mark on my credit from when I left my job at PetSmart because I couldn't take it anymore.

When I was 23 years old, I saw that PetSmart was advertising positions for pet groomers and a "free" training. I figured that if I wanted to advance my career, I might benefit from some training, but I'm always really cautious about taking on debt and worried about my credit, so the possibility of free training was really interesting to me.

I got the job and after a few months working as a pet bather, and before starting the training they made me sign a training repayment agreement provision—which I now call a "TRAP," and that also makes sense because it really did make me feel trapped in my job. I didn't read the agreement too closely, but what it said was that the training wasn't free at all. It actually cost \$5,000, and I'd need to pay back that \$5,000 if I left within a two-year period after the beginning of the training. In addition, they told me that I could either buy my own grooming tools or they would give me tools, but those tools also weren't free. They were just another \$500 in debt to PetSmart. So if I left my job before they wanted me to, I'd owe them \$5500 total.

The name "grooming academy" made it sound to me like I was going to get important and valuable training, but it wasn't anything like that. I didn't get any kind of license or accreditation or anything. And my actual training was only really a few weeks. During the first week, I just worked my way on my own through papers that PetSmart gave me. The next couple of weeks, I was supposed to practice grooming on dogs. The person giving me my training was the manager at the salon, but the salon manager was really busy running the salon, doing grooms, and responding to customers—so most of my practice cuts I just did on my own. When I needed to learn how to do a certain kind of groom for a specific breed, but that breed didn't come into the store, they told me to just give the cut I needed to give to whatever breed was available and then to recut the dog's hair to a more appropriate cut. To the extent I was learning anything, it was really just because I was grooming dogs for PetSmart's customers—and PetSmart was charging those customers for my grooms. It wasn't because PetSmart was actually teaching me anything useful.

After the grooming academy, I was still not a full groomer. Instead, I received only a fraction of groomer pay during 200 additional "supervised" grooms. But none of those grooms were supervised at all. Just like at the academy, I was learning on the job.

Over time my job at PetSmart became worse and worse, I was basically making minimum wage or just above it, but my job was impossible. I worked non-stop, through all of my breaks. I was exhausted. I was dealing with customers yelling at me. It was so stressful.

I knew I could make more money working just about anywhere else, but I was terrified about that \$5,500 debt. I couldn't afford it, and I didn't want to hurt my credit because I'm trying to build up good credit and save money. I felt completely stuck.

I asked my manager what I could do, and they told me that if I worked hard enough and cut enough dogs and sold enough product, that I could effectively work off that \$5500 debt early. I trusted the manager, even though I didn't see that in a contract. So that's what I did, I worked so hard, cutting dogs and doing everything they asked me. I couldn't take the work anymore, and I was struggling to pay the rent. Finally, I'd made enough money to quit.

I thought that my nightmare was over, but a few months later, I was checking my credit, and I saw that my credit score which I'd worked so hard on had gone down by a lot. It was because of a debt to PetSmart for \$5,500. Apparently PetSmart had decided to send the debt to my TRAP to collections.

I was so sad and hurt to see that. I felt like I didn't know what I was supposed to do. I always thought that you're supposed to be able to work where you want to, but I had this debt to PetSmart keeping me trapped in that job. I now see that the point of the PetSmart training wasn't to give me training I'd need for professional growth, it was to keep me indentured to PetSmart.

Thank you so much for listening to my story.

STATEMENT SUBMITTED BY CASSIE PENNINGS

**U.S. Senate Committee on Banking, Housing, and Urban Affairs
Member and Staff Listening Session on New Consumer Financial Products
September 7, 2022
Testimony of Cassie Pennings**

Good morning Chairman Brown and members of the Committee. Thank you for the opportunity to testify today.

My name is Cassie Pennings and I am a nurse and a proud member of CWA Local 7799.

I remember the courage it took to believe in myself enough to apply to nursing school.

For me, nursing isn't just a career path, it's an identity. It's who I've always been; it's coming home.

As I entered the field of nursing amidst the COVID-19 pandemic, veteran nurses apologized to me on behalf of the state of the profession and assured me, "It wasn't always like this."

One of the worst shifts I've experienced occurred when I had been a nurse for just 11 weeks. As a part of the new graduate nurse program, we are promised to be paired with a nurse mentor who will stay, "elbow to elbow," with us for at least the first 12 weeks, but on this shift, my mentor was preoccupied with multiple emergencies, leaving me to take care of my five patients alone, each of whom required high levels of care. I remember feeling like I couldn't physically be in enough places at once, and then I received an ICU admission. I was running to one patient's room, checking one task off the list, and running back to attend to another one of my six patients. By the time I was able to prioritize spending more than a few minutes with my new admit, who was elderly, confused, and incontinent, I realized he had been laying in his own urine with a fresh spinal incision. Doing the bare minimum was all I could manage under the circumstances afforded to me.

It was in that exact moment the luster of nursing and my dream of fulfilling this calling, took a hard reality check. For the first time I could truly empathize with the feelings of senior nurses: the care I delivered did not align with my moral compass. It felt inhumane.

I kept thinking, “Somebody loves him. He belongs to someone. He is someone’s loved one.” That’s when it became tangible that modern healthcare is fueled by valuing profits over patients. That was just under 3 months into my nursing career.

In describing the shift to my manager I expressed, “It was not safe for the patients and it was not safe for my license. Never again.” Nonetheless, patient ratios continued to increase.¹

As the injury the pandemic has left on the field of nursing persists, the responsibility is continually placed upon the worker. While walking an average of 6 miles every shift, I still struggled with crippling feelings of guilt when the limitations of staffing made it impossible for me to deliver the basic care these human beings deserved. I learned this was moral distress, a precursor to burnout, yet we continue to ask why the nursing shortage persists. Despite being one of the most profitable healthcare systems in the nation, my former employer responded to cries for help from the frontlines with breakfast burritos and free water bottles. It is imperative that Congress pass Chairman Brown’s bill to mandate safe staffing ratios.

Historically resilient, I found myself in survival mode. It took everything I had left to keep my space clean, exercise, and feed myself. Rather than advocating for my fellow healthcare workers and patients in forums like this, I had to turn down opportunities because the healthcare system has successfully oppressed me, a labor activist.

The hospital’s greed and neglect forced me to leave this summer, but that same greed made it almost impossible to leave. Leaving my job felt like exiting an abusive relationship.

¹ In an article published in The Journal of the American Medical Association, researchers at the University of Pennsylvania found that each additional patient in a nurse’s workload meant an increase of about 7 percent in the likelihood that the patient would die within 30 days of admission. The difference from four to six and from four to eight patients per nurse resulted in a 14 percent and 31 percent increase in mortality, respectively.

The only way to get a job as a new nurse in a hospital is to enter a new nurse residency program and sign a financial contract, with no sign-on bonus. As a result of my choice to remove myself from this situation, I am now indebted \$7500 to the hospital because of a Training Repayment Agreement Plan—ironically, “TRAP” for short. That’s two months of my salary. That’s more than six months rent. Suffice it to say, we certainly did not receive \$7500 worth of benefits through the program. Hospitals have demonstrated they would rather trap their employees with the threat of debt than incentivise them to stay. Upon resignation, I received an email informing me that there would be money withheld from my remaining paychecks to help cover the debt, making it even more impossible for some nurses to be able to afford to leave. Any uncollected debt would be turned into collections. This e-mail was vague, not detailing any sort of schedule or amount for these withholdings. My heart dropped as I received the following paycheck and recognized half of it was missing.

As you consider policy moving forward, I ask you to remember my patients, think of your loved ones, and to prioritize empowering and protecting the people at bedside with them by banning abusive practices like TRAPs. Thank you.

STATEMENT SUBMITTED BY RAM PALANIAPPAN, CEO, EARNIN

Chairman Brown, Ranking Member Toomey, and Members of the Committee, thank you for the opportunity for Earnin to provide a written statement for the record. We believe that EWA (Earned Wage Access) products can help workers overcome financial challenges within a framework that protects them, without stifling innovation that drives positive change in workers' lives. Earnin seeks to work with the Banking Committee to craft legislation to protect this important financial tool for workers to access their pay once it is earned, without having a vendor or pay date forced on them.

Earnin's mission is to build products for a fairer financial system that works for people. Millions of families suffer from the consequences of living paycheck to paycheck.¹ Although the issue of a livable wage continues to be debated in the United States, the real-life impact of paycheck timing is of critical importance to many Americans. Earnin is designed to free people from the employer-centric 2-week pay cycle and give them control of their money, starting from when they earn it.

The employer-centric approach grew from a desire to ease the burden on employers seeking to implement the federal income tax in the 1940s.² One consequence of the monthly or biweekly periodic pay schedule is that it limits workers' access to money they earned and creates everyday hardships, because workers' financial obligations often do not coincide with employer-chosen pay dates. As a result, workers delay obtaining much-needed goods and services or put off medical care until they receive their next paycheck.³ In an era of on-demand technology, we believe that earned wage access provides workers with a choice of how to obtain near-real-time access to the funds they earn without the excessive fees, challenges, and pitfalls of traditional tools like debt, bank account overdrafts, and payday lending.

The Liquidity Gap

Conversations about supporting low-income Americans often revolve around the wealth gap: the fact that some people have much less in assets and net worth than others do. Those conversations conceal a more insidious and pervasive problem that families face daily – the liquidity gap. The liquidity gap is when people have a paycheck coming in next week, but they need to pay rent or buy groceries this week. This phenomenon is felt disproportionately by people of color. Research suggests⁴ that a sudden loss in income will have a greater effect on a Black or Hispanic household than a white household.

Harmful impacts when the liquidity gap is ignored

Historically, low-income Americans facing a significant expense without the cash available to cover it have turned to expensive and often predatory forms of liquidity.

¹ 54% of consumers in the U.S. today live paycheck to paycheck, including 53% of those who earn \$50,000 to \$100,000 per year, <https://www.pymnts.com/study/paycheck-to-paycheck-consumer-finance-american-households/>

² <https://www.thenation.com/article/archive/breakdown-why-are-we-paid-every-two-weeks/>

³ E.g., <https://www.businesswire.com/news/home/20181023005517/en/Earnin-Survey-Shows-Majority-of-Americans-Are-Delaying-Medical-Care> ("More than half of Americans (54 percent) have delayed medical care for themselves in the past 12 months because they could not afford it.")

⁴ https://www.nber.org/system/files/working_papers/w27552/w27552.pdf

These types of financial services often trap consumers in a never-ending cycle of debt. In turn, the burden of these high fee forms of short-term credit falls disproportionately on people who can least afford it.

As the National Consumer Law Center (NCLC) testified at the June 2021 House Financial Services Committee hybrid hearing, *A Biased, Broken System: Examining Proposals to Overhaul Credit Reporting to Achieve Equity*, "There is need to mitigate the punitive impact of a system that treats consumers who have fallen on hard times as irresponsible deadbeats."⁵ Earnin is doing exactly that: empowering consumers to take charge of their financial future. Our pay what you choose, non-recourse model speaks to the trust we have in consumers; that they can responsibly self-regulate and manage their budgets.

Consumers deserve solutions that genuinely address the liquidity gap, not exploitative tools that prey on consumer vulnerability. We are confident that Earnin's current EWA offering unquestionably helps to align income and expenses safely, while also enabling consumers to avoid reliance on payday loans and overdrafts.

What does "safely" mean? Earnin believes a safe EWA product means:

- Flexibility on revenue model, as long as there is a no-cost option, and services are non-recourse
- No employer data sharing (worker privacy)
- Reasonable estimation of accrued earnings
- No selling of customer data
- No reporting to credit bureaus

Earnin provides a suite of services to help families manage their money

Earnin's comprehensive suite of tools include: Cash Out, which provides access to income as it's earned; Earnin Express, a free, FDIC insured, demand deposit account that gives people the option to receive their paycheck up to two days early; Balance Shield, a low balance alert to help maintain a positive bank balance; and Tip Yourself, an easy way to set aside money to reach savings goals. With Earnin's EWA product, Cash Out, users can access up to \$100 of their accrued earnings per day, and up to \$750 of their accrued earnings per pay period.

Earnin is consumer-friendly

Earnin is a no-mandatory fee, non-recourse, no-interest financial tool. Users can choose to provide voluntary "tips," though one's access to Cash Out or any of our financial tools is in no way dependent on tipping, or they can opt in to transfer earnings within minutes, which we call Lightning Speed, for a low transparent tiered rate of \$1.99 to \$3.99. Credit agencies and debt

⁵ Testimony of Chi Chi Wu, National Consumer Law Center Before the U.S. House of Representatives Committee on Financial Services regarding "A Biased, Broken System: Examining Proposals to Overhaul Credit Reporting to Achieve Equity" June 29, 2021

collectors are never involved, and Earnin bears the entire risk if a Cash Out isn't recovered – the consumer bears none.

Furthermore, we provide our services "Direct to Consumer." This means that anyone with a paycheck can use our services – regardless of employer, no matter how big or small. Any employee in the U.S. with a bank account who receives their paycheck via direct deposit can use Earnin, including employees of small business and public employees.

Our Tip Model is Voluntary and Totally Transparent

Our tip model is completely voluntary and transparent. Our model allows consumers the flexibility to choose whether to tip and, if so, in what amount. In the second quarter of 2022, 53% of customers used the service without tipping at least once. When consumers choose to tip, the average is less than typical ATM fees (for example, the Senate Federal Credit Union's ATM machine charges a \$3 fee to withdraw \$20).

Tip models are structured in accordance with CFPB guidance and compliant with a voluntary agreement with the California Department of Financial Protection and Innovation (DFPI). The CFPB stated that voluntary tips are not a finance charge,⁶ but that tipping models "*are likely to benefit consumers and unlikely to lead to the risks and harms described below in Market Concerns,*" and that they are "*likely to be beneficial for consumers across the spectrum.*"⁷ The state of California signed a [Memorandum of Understanding](#) also stating voluntary tips are not finance charges: "*For the avoidance of doubt, subscription fees, voluntary gratuities and transaction fees for expedited delivery of advance pay are not considered "finance charges" for purpose of TILA and thus are not included in an APR calculation.*"⁸

Existing consumer protection laws already address EWA

In 2017, the CFPB promulgated the Payday, Vehicle Title, and Certain High-Cost Installment Loans (the "Payday Rule")⁹ that specifically exempted EWA or "no-cost advances" from coverage under the Rule due to the reasons stated in the above section: that Earnin's model prevents the risks and harms sought to be addressed by the Payday Rule.

Despite being exempted from the Payday Rule, Earnin maintains a comprehensive compliance program. This includes policies and procedures related to electronic funds transfers, and unfair, deceptive, or abusive acts or practices (UDAAP), as well as data privacy laws, such as the Gramm-Leach-Bliley Act (GLBA), and financial crimes regulation from the Treasury Department's Office of Foreign Assets Control (OFAC).

⁶ https://files.consumerfinance.gov/f/documents/201710_cfbh_final_rule_payday-loans-rule.pdf Page 216

⁷ https://files.consumerfinance.gov/f/documents/201710_cfbh_final_rule_payday-loans-rule.pdf page 281

⁸ <https://dfpi.ca.gov/wp-content/uploads/sites/337/2021/01/Admin-Action-Archivehours-inc.-Memorandum-of-Understanding.pdf>

⁹ <https://www.govinfo.gov/centid/t/pkq/FR-2017-11-17/pdf/FR-2017-11-17.pdf> Page 265

In March 2022, the Biden Administration released the Treasury Green Book, specifically calling for clarification that Earned Wage Access not be considered loans.¹⁰ Earnin has worked with industry colleagues, as well as state and federal lawmakers to craft a legislative framework that creates regulatory certainty for EWA providers. This framework includes choice and strong consumer protections for consumers of EWA, and a prohibition on sale or disclosure of non-aggregated/anonymized consumer data to third parties, except as necessary to provide services to the consumer or in accordance with a consumer's written consent. Any data shared with government agencies, such as with the U.S. Department of the Treasury to help them better understand how EWA helps working families, is aggregated and anonymized. We seek to work with the Banking Committee on this industry legislative framework.

Community Impact

Our customer impact is backed by data. Our customers use Earnin to pay for essentials on time; top uses are for food, groceries, gas, utility bills, avoiding overdrafts, rent, and unexpected expenses.¹¹ According to the US Census Bureau, 40% of Americans are having difficulties paying for necessities.¹² If they had access to their wages as they earned them, it would lessen the stress and burden in workers' lives.

A May 2021 research study of 4,735 EWA consumers showed that EWA helps working families stuck in a traditional pay cycle with the tools they need to manage their finances.¹³ The study found that without EWA, 44% of users would otherwise consider not paying certain bills and more than one-third of consumers would deliberately overdraft or use a payday loan because of cash flow constraints.

Additional findings from the study show:

- 92% of consumers given EWA reported that it helped them to pay bills on time, avoid overdraft fees and payday loans, and become less dependent on credit cards; empowering them to achieve at least one of their financial goals in 2020.
- An overwhelming majority of consumers (91%) said they understand how the EWA service works and understand the associated fees.
- 82% reported feeling less stressed about their financial situation, 81% feel EWA is the best option to help them manage their spending, and 77% reported having improvement in their overall mental health after using EWA.

As noted above, Earnin is available to anyone with a job and a bank account. Earnin doesn't charge users for its services or force users to choose between re-borrowing, defaulting, or

¹⁰ <https://home.treasury.gov/system/files/131/General-Explanations-FY2023.pdf> page 107

¹¹ Earnin internal survey, Dec 10 2020 - Jan 1, 2021: 1122 Responses

¹² https://finance.yahoo.com/news/difficulty-paying-bills-tops-pandemic-191151129.html?fr=sycsrp_catchall

¹³ Research was conducted online by FTI Consulting's Digital & Insights team, on behalf of Brigit, MoneyLion & Earnin. FTI Consulting researched n=4,735 of Brigit, MoneyLion and Earnin's Direct to Consumer (D2C) Earned Wage Access (EWA) service consumers between the dates of April 21st, 2021 – May 18th, 2021, and results were weighted in equal proportions to ensure equal representation among the consumers of each participating company. <https://www.earnin.com/assets/pdf/earnin-infographic.pdf>.

falling behind on other obligations. Because failure to repay a Cash Out does not cause injury to anyone but Earnin, Earnin's service is unlikely to present consumer protection concerns often associated with traditional lending. To the contrary, Earnin provides a valuable consumer benefit: Earnin's service puts workers, not their employers, in charge of when they get paid, and it gives users the ability to manage their finances without having to rely on exploitative traditional lending products.

Earnin is a service that is valued by millions of Americans

In 2022 year to date, Earnin customers used our EWA product, Cash Out, 37.5 million times to access \$3.2 billion in earnings. As of September 2022, Earnin has performed 183 million transactions and provided access to \$14.5 billion in earnings for its members in total. Our members are a cross section of America, and a survey of our customers in late 2020, showed that 68% of them were 25-44 years old, 77% made less than \$75,000 per year, and 70% identified as female; 36% identified as white, 32% as black or African American, and 18% as Hispanic or Latinx.

Employees at more than 400,000 different US employers use Earnin, including over 180,000 small business employers. More than 100 Congressional staffers use Cash Out to access their accrued earnings.¹⁴

Earned Wage Access is non-recourse liquidity. It is not credit.

As the Committee explores EWA and the best approach for supporting and protecting consumers, some have suggested regulating EWA as credit. We urge the Committee to reject that view – at least with respect to Earnin's model – for two simple reasons:

1) Earnin's approach to EWA fundamentally falls outside the definition of credit

Earnin's approach to EWA falls outside of the definition of credit because:

- a. EWA provides access to accrued earnings, providing timely liquidity as an alternative to credit to synchronize the timing of income with the timing of bills.
- b. There are no finance charges and no interest paid by consumers.
- c. Customers are not required to make any mandatory payments to obtain EWA from Earnin.
- d. EWA (as opposed to 'early pay' or 'payday' lending) is non-recourse. The transactional risk is borne entirely by the provider rather than consumers. Providers have no legal right to repayment and cannot report to credit reporting agencies or engage in collection activities (see Earnin Terms of Service¹⁵). If a customer does not repay their funds, the only recourse available to providers is to deny future access to the service. The amount involved in an EWA transaction does not roll over or compound.

¹⁴ Earnin internal data, October to November 2021

¹⁵ <https://www2.earnin.com/privacyandterms/>

2) Regulating EWA as credit will lead to worse outcomes for consumers

EWA is fundamentally different from both the predatory credit products that have taken advantage of struggling Americans for years and the exclusive products that make liquidity available to wealthier Americans but remain off-limits to those most in need. Moreover, forcing EWA into the "credit" system seems to shoehorn a new consumer-friendly approach into a broken system that often disadvantages consumers.

Regulating EWA as credit would:

- a. Transfer the downside risk from providers to consumers. Currently, EWA providers bear all of the legal and financial risks of non-repayment. If one were to treat EWA as credit, customers would have a legal obligation to repay. This would greatly increase the costs of non-payment by making EWA recipients vulnerable to debt collection, and increasing the risk of adverse credit reporting which could follow them for years to come.
- b. Impact the accessibility of EWA products. Higher fees will make the products less accessible leading to a cycle of debt.

Accessing earnings is closer to an ATM transaction than credit

ATMs provide consumers with faster, more convenient access to their funds. We believe that EWA is more similar to ATMs transfers than credit and support clear disclosures on pricing structures similar to ATM fee disclosures. We also support notice to consumers of the next scheduled debit, as well as clarity on the non-recourse nature of the EWA products.

Conclusion

Thank you for your commitment to consumers and for being thorough in examining the nuances of Earned Wage Access cash flow products. Earnin supports a regulatory framework for EWA that protects consumers while, at the same time, recognizing that EWA is inherently different from traditional credit or payday lending. We also support consumer choice and flexible solutions that meet consumers where they are. We look forward to the opportunity to work with the Committee to help achieve our mutual goals of addressing the liquidity gap that impacts the lives of millions of Americans today and to ensure that there are EWA-specific consumer protection frameworks that aid workers and help ensure more fair and equal access to America's financial system.

Frequently Asked Questions about Earnin

You really make money from tips? What's the catch?

There is no catch. As of March 2022, customers who elect to get their earnings transferred instantly now pay a small amount of up to \$3.99, but the no-cost transfer over ACH (1-3 business days) option will always remain. If customers find our service valuable, they are welcome to leave us a tip, but they can always choose \$0, and many do. Tipping has no bearing

on their ability to access the service. And, we do not generate any revenue by selling customer data. In the second quarter of 2022, 53% of customers used the service without tipping at least once. The average tip is less than an ATM fee,¹⁶ one tenth the cost of an overdraft fee,¹⁷ and far less than a payday loan fee.¹⁸

We only get paid if we delight our customers enough to want to voluntarily give us their financial support. While we acknowledge that there is some potential for abuse by unscrupulous actors, we strongly believe in consumer choice, innovation to help consumers and workers, and addressing potential issues with reasonable regulation that neither stifles innovation nor harms consumers. We believe that worker dignity is paramount and best served by providing convenient and timely access to the money that workers earn as they earn it, to help them pay their bills on time, with no more late fees, no more overdraft fees, and without being driven to use disadvantageous alternatives such as credit, debt, overdraft fees, check cashers, and payday lenders.

Aren't tips deceptive?

Tipping is voluntary and transparent, and ensures we only succeed as a business if our customers find our service valuable enough to reward us with a tip. Our customers tell us they like this flexibility, because it allows them to access the service at lower, or no, cost if funds are tight, but the ability to tip a higher amount when they have more flexibility and would like to support the service.

Tens of millions of Americans choose to tip every day when they buy a coffee, a meal, or a beer, when they use food or grocery delivery services, "task" services, ride sharing apps, and a wide variety of other services – both in person and online. Most Americans have worked for tips in their life or know someone who has. Even Act Blue relies on tips for their business model. While tipping norms have shifted across the economy, tipping remains a way to reward exceptional service and give customers choice in how much they choose to pay for a given service. Earnin's tip model is no different. Americans are very familiar with tipping, and understand what it entails and what it does not.

Is selling customer data part of your revenue?

Earnin does not sell customer data. The security of customer information is our top priority. We only use data in accordance with our Privacy Policy¹⁹. We do share anonymized and or aggregated data with government agencies such as the U.S. Department of the Treasury and California Department of Financial Protection and Innovation, or certain research institutions such as Opportunity Insights to better understand labor markets and how EWA helps our customers.²⁰

But what really happens if someone doesn't pay you back?

¹⁶ The total cost of the average out-of-network ATM withdrawal was \$4.59 in 2021.
<https://www.bankrate.com/banking/checking/checking-account-survey/>

¹⁷ The average non-sufficient funds fee was \$33.58 <https://www.bankrate.com/banking/checking/checking-account-survey/>

¹⁸ <https://www.consumerfinance.gov/ask-cfpb/what-are-the-costs-and-fees-for-a-payday-loan-en-1569/>

¹⁹ <https://www.earnin.com/privacyandterms>

²⁰ <https://opportunityinsights.org/>

Earnin simply pauses the Cash Out service for that customer. If they would like to access Cash Outs in the future, they may do so by contacting customer support and paying their unpaid balance. This ensures consumers don't overextend themselves. Rollovers, common in the short term lending context, are not possible. There is no penalty fee if the customer chooses to pay after their service has been paused. Finally, customers' credit is not affected. Our customers tell us the fact that using EWA does not affect your credit score is one reason why they like and trust our service.

Does EWA trap people in a cycle of dependency?

No. Families working paycheck to paycheck are currently beholden to the 2-4 week pay cycle, trapped in a system that does not account for real life factors, like an unexpected expenses that do not wait for payday – anything from car repairs to modest medical bills, to unexpected overtime pay to a child care worker. Research has shown that the current payroll system has been found to have a number of adverse effects.²¹

EWA provides workers with choice and freedom from dependency on the payroll cycle and a financial system that frequently disadvantages them.

The median bank balance of Earnin customers is \$125, while the median accrued earnings is \$640. With \$125, workers' are just trying to make it until payday; high fees do not matter if bills are paid and can be dealt with after payday. With access to all \$765, workers are much more equipped to make budget conscious decisions, thus less likely to be trapped in a cycle of debt and dependency. Unexpected expenses cause stress and snowball into much bigger expenses. Instead of workers having to put such expenses on credit cards, borrow from friends or family, incur expensive debt or overdraft charges, or sell other goods for fast cash, for example, Earnin provides consumers alternative options for meeting their needs without being trapped by the cycle of credit or the need to turn to expensive and often predatory forms of liquidity like payday loans and bank account overdrafts.

Should Business to Business and Direct to Consumer Models be regulated differently?

There is robust competition in the EWA space with more than 25 companies offering these services. All business models have slight variations, but they largely fall into two categories of how the users procure the product 1) business to business, where an employer such as Walmart or Amazon would offer EWA as an optional perk to their employees, and where net earnings are estimated based on information from employer payroll systems or 2) direct to consumer, where EWAs are obtained directly by consumers, and net earnings are estimated based on wages deposited into consumers' bank accounts. Earnin is fairly unique in the space, as we provide EWA services directly to consumers and also have partnerships with large employers.

Although the procurement method may differ, EWA companies provide largely the same service; they estimate net wages, advance wages to the worker based on those estimates, then get repaid on payday; and they should be treated in a similar manner for regulatory purposes. We

²¹https://www3.nd.edu/~wevans1/working_papers/evans_moore_JPUBECON.pdf

don't regulate other industries, like insurance, differently based on whether it is purchased through an employer or directly by a consumer, and EWA is no different.

	Business to Business EWA	Earnin/Direct to Consumer EWA
Procurement method:	Employer chooses the EWA provider. Employers may choose what is best for them, not their workers.	Consumers choose the EWA provider based on what is best for their individual situation.
Wage Estimation:	EWA provider estimates net wages based on payroll data. ²² Note this is likely historical data, as the timing of this data transmission varies greatly.	Earnin estimates wages based on past earnings or uploaded time sheets.
Fees paid by customer:	Customer pays fees set by the provider. Employers may choose to pay the fees, or they may pass the fees through to employees.	Customers choose a fee amount (including \$0).
Method of funds delivery method:	Customers receive funds on a payroll card, or in their bank account via ACH or Debit.	Customers receive funds in their bank account via ACH or Debit.
Method of funds recovery:	EWA provider is repaid on payday; provider may debit bank account directly; take custody of customer paycheck to repay themselves before transmitting paycheck to worker; or receive a disbursement from employer to EWA provider.	Customers authorize Earnin to debit the amount of the Cash Out + voluntary tip (if any) on their next payday, or customer may opt to have their pay routed through an Earnin Express account, with any wages repaid, and remaining funds pushed to customer's external bank account

Benefits of Direct to Consumer:

- **Portability:** Business to business models are by definition tied to a specific employer. The Direct to Consumer model allows workers to control whether or not they have the access to the service should they choose to switch jobs.

²² Daily Pay uses a "proprietary"... "Dynamic Income Algorithm" to estimate wages. <https://fintechmagazine.com/venture-capital/fintech-profile-dailypay-payroll-game-changer>

- **Worker privacy:** Workers may not want their employer to know they use EWA, they should have the ability to enter into a transaction that is not subject to potential snooping by employers acting improperly.
- **Competition:** The provider an employer uses for EWA may not be the right one for the consumer. The consumer should have options to choose an EWA provider that works for them. Employers may choose what is in their best interests, and that will not always align with a worker's choice. Employers may choose mandatory fees, because they are not paying those fees. Many of Earnin's customers are employed by companies that offer EWA, but they choose us instead. Legislators should not put their thumb on the scale to benefit one business model. They should allow workers to vote with their pocketbooks and choose the service that is best for them.
- **Flexibility for the worker:** Depending on the business model, some EWA providers allow independent contractors with different income streams to access their income early. This flexibility should be preserved for maximum consumer benefit as work looks different to different people.
- **Levels the playing field for small businesses:** Many employers, such as small businesses and government agencies are likely not able to integrate with B2B EWA providers. This disadvantages them in the labor market vis a vis large employers, because they would not be able to offer a benefit that some workers value. D2C allows a corner grocery store to compete with Walmart for talent that would be impossible under a B2B only regulatory mandate.

Alternatives in the market: What happens if various small dollar liquidity options are not repaid

Liquidity Option	Cost	What happens if you don't pay
Overdraft	\$30-35 per transaction.	Must be repaid when new funds go into account, or the account will be closed. Can generate multiple fees per \$100 overdrafted depending on the number of transactions. No negative impact on credit score, but may lose access to your banking account and therefore the banking system.
Payday Loan	\$15-25 per \$100 borrowed, fees and rollovers can add up to hundreds more.	Depends on state law, but generally can be rolled over a certain number of times, generating additional fees and interest each time. Amount owed could balloon to several times the amount originally

		owed. Debt can be sold to a collections agency and will likely be reported to credit bureaus damaging your credit score.
Credit Card	No fee if paid fully at the end of the first month, with interest rates averaging around 15% or more thereafter.	If the minimum payment is not paid, large fines will quickly add up, up to \$40 plus interest. Credit score will be ruined.
Earnin	No mandatory payment to access Earnin. Any payment is voluntary, and the average "tip" is less than an out-of-network ATM fee.	Cash Out service paused until repayment. Customer still has access to other Earnin services. No late fees, no rollovers or collections, no reports to credit agencies.

Earnin is the clear choice for consumer benefit.

Why our customers choose Earnin in their own words (actual customer reviews):

Nevada Customer, Net Promoter Score 10/10

This has been a lifesaver for me. It is cheaper than a payday loan and the tip is all up to how much you can afford. I would recommend this to everyone.

AdrenalineJack, Net Promoter Score 10/10

The service has been easy and free; it has provided money at times when it was absolutely essential. I was able to tip a small amount on the last transaction but not the first. Hopefully I'll be able to slowly contribute more as things even out.

Jennifer Burns ★★★★★, App Store Review

It's been great. I love I can choose a tip instead of paying high fees.

Joseph Spinelli ★★★★★, App Store Review

You guys have saved my butt on so many occasions and I'm happy to report that my credit went up because of this app! And I learned everything I needed to be more fiscally responsible. Love love love it!

Irmajovens ★★★★★, App Store Review

A helping hand

Using Earnin to get me through some tough spots has helped me better learn to manage debt and credit card usage. Also I have been able to pay down over 4K in debt while on their platform. Thank you guys.

Nespar68 ★★★★★, App Store Review

Amazing

This app helps me pay my credit cards earlier and that helps lower my credit. Boom!

Gunitilimia ★★★★★, App Store Review

Amazing

This app has helped me out many times and has kept me from having OD fees also without having to take out loans and screw my credit up. I love Earnin!

Purrlow ★★★★★, App Store Review

Gratitude!

Discovering this app has saved me from lowering my credit score! Thank you!

Izzy sparxxx ★★★★★, App Store Review

I wish this app existed a decade ago

I would have never used a single credit card. This app is truly a lifesaver especially recovering from the loss of a job and Covid last year. It's help me get back on my feet financially

Anita Kyne ★★★★★, App Store Review

Easy to use. If I need funds sooner than payday, I can get cash instead of using credit.

Tamiamia1210 ★★★★★, App Store Review

Best app ever NO MORE OPENING CREDIT CARDS

This app is the best especially now when we are in quarantine and in need of extra money. This app is fast and it takes the cash back on paycheck day which I think is AWESOME. No more stupid credit cards messing up my credit this app is a lifesaver. Thanks everyone who works at earnin from employees to managers to online chat people to the CEO to literally everyone who makes this experience the best.

Additional Reading on Earned Wage Access:

[White Paper on Earned Wage Access Trends](#) (from the Financial Health Network)

[Earned Wage Access Services - Legal and Policy Analysis](#) (from Earnin's counsel Paul Hastings, LLP)

[Survey Results on Direct to Consumer Earned Wage Access](#) (FTI Consulting, May 2021)

[EARNED WAGE ACCESS AND THE END OF PAYDAY LENDING](#) (Jim Hawkins, Boston University Law Review)