ASSEMBLY COMMITTEE ON BANKING AND FINANCE

SUMMARY OF LEGISLATION 2019-2020

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October 15, 2020

Members of the Legislature and the People of California:

I am pleased to provide this summary report on the activities of the Assembly Committee on Banking and Finance. This report contains summaries of the measures referred to the committee and documents related to informational hearings held by the committee during the 2019 – 2020 Legislative Session.

The Assembly Banking Committee had a historic legislative session in 2019 – 2020. Committee Members advanced bills that enact important protections for consumers related to personal installment loans, student loans, and a broad set of financial products that were previously unregulated at the state level. The successful effort to revamp the state financial regulator will fundamentally change how California – and possibly other states – approaches its responsibility to oversee a fair and transparent marketplace for financial products and services. These successes were hard-fought and their benefits will be enjoyed by California families for years and decades to come.

In addition to work led by Committee Members, the Committee molded and approved bills introduced by other Members of the Legislature. The Committee added critical protections to ensure that a local government agency includes appropriate safeguards to protect taxpayer money if the agency tries to establish a public bank. The Committee worked to establish a licensing framework for debt collectors in a manner that garnered industry support without compromising important protections for debtors. The Committee also approved a variety of measures that were signed into law, including bills related to cannabis banking, wage theft prevention, and requirements to diversify corporate boards.

Financial services operate in the background of our economy and are often overlooked by consumers until they encounter a problem. Due to the abstract, opaque, and confusing nature of many financial services, people rarely invest a similar level of aspiration, planning, and shopping around for a financial product as they do for tangible products – like a car, a house, or a vacation. But these very characteristics that cause people to overlook financial services are the same characteristics that call for scrutiny from policymakers. Appropriately balanced regulations have the ability to improve outcomes for consumers and responsible providers alike.

Consumers and businesses use financial products to help them accomplish goals in their lives. Similar to electricity and other utilities, a financial product is not an end unto itself, but rather it serves as a mean to some other ultimate objective. For example, a consumer does not have innate demand for a mortgage; the consumer only wants a mortgage because it allows them to own a house. Just as public policy prevents predatory pricing of electricity or contaminated water from entering homes,

public policy can establish fair guardrails that underpin healthy markets for financial products and services.

While the 2019 – 2020 Legislative Session moved the needle on several important issues, this important work must continue in the next session. The economic consequences of the COVID-19 pandemic continue to reverberate across the state and are exacerbating the entrenched inequalities in our society. Low- and moderate-income Californians, communities of color, and small business owners have felt the most acute pains, while the top 1% and large corporations enjoy all-time highs in the stock market. In addition to the economic problems caused by the pandemic, the Committee was constrained in the number of bills it heard in 2020, leaving unfinished business that will resume next year.

I would like to acknowledge and thank the Members of the Banking Committee for their service. I appreciate the time and dedication of my colleagues to understand these important issues and their contributions to healthy debate during committee hearings.

More information on these and all other legislative measures can be found online at www.leginfo.ca.gov. If you have questions or would like additional information about the bills summarized in this report, or if you have questions about the Assembly Committee on Banking and Finance, please feel free to contact the committee staff at (916) 319-3081.

Sincerely,

Monique Limón
Assembly Banking and Finance Committee, Chair

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BUSINESS ENTITIES

AB 979 (Holden)

Corporations: boards of directors: underrepresented communities.

Requires each publicly held corporation whose principal executive offices are located in California to have a minimum number of directors from underrepresented communities on its board of directors.

Status: *Chapter 316, Statutes of 2020*

AB 1305 (Obernolte)

Limited liability companies.

Specifies that the provision requiring a limited liability company that has filed a certificate of cancellation to be canceled and to cease all powers, rights, or privileges does not prevent the limited liability company from existing for the purpose of winding up its affairs.

Status: Held in Senate Rules Committee

AB 2927 (Cervantes)

California Revised Uniform Limited Liability Company Act: Secretary of State: filing procedures.

Requires the Secretary of State, after accepting a filing of an articles of organization and determining that the filing does not comply with the above name requirements, to provide written notice to the LLC requesting an amendment, in accordance with specified timelines and procedures. Requires the Secretary of State, if the LLC has not submitted completed documentation to meet the amendment requirements, to send notice to the LLC that the next biennial statement of information shall not be accepted until the LLC either amends its name or submits appropriate documents to meet these requirements. Requires the Secretary of State, if the issue of noncompliance is brought forward by a party other than the Secretary's office, to review the complaint and make a determination of its validity within 30 days after submittal of the complaint.

Status: Held in Assembly Banking and Finance Committee

SB 522 (Hertzberg)

Business entities: filings.

Streamlines the naming requirements of corporations, limited partnerships, and limited liability companies by creating uniform standards that business entity names are distinguishable in the records of the Secretary of State and that names are not likely to mislead the public.

Status: *Chapter 316, Statutes of 2020*

SB 540 (Jones)
Nonprofit public benefit corporations.
Allows nonprofit corporations to offer split-dollar life insurance policies as compensation when secured by the cash value or death benefit, instead of both the cash value and death benefit.

Status: *Chapter 250, Statutes of 2019*

CANNABIS BANKING

AB 1525 (Jones-Sawyer)
Cannabis: financial institutions.
Clarifies that no state law prohibits an entity from providing financial services, as specified, to a licensed cannabis business. Permits a cannabis business to authorize a state regulatory agency to share the business' track-and-trace data with financial institutions.

Status: *Chapter 270, Statutes of 2020*

SB 51 (Hertzberg)
Financial institutions: cannabis.
Provides for the licensure and supervision of cannabis limited charter banks and credit unions authorized to offer limited depository services to cannabis businesses.

Status: Amended out of committee’s jurisdiction subsequent to passage by the Committee

CONSUMER CREDIT

AB 539 (Limón)
California Financing Law: consumer loans: charges.
Prohibits California Financing Law (CFL) licensees from receiving charges on a consumer loan at a rate exceeding 36% per annum plus the Federal Funds Rate for loans with a principal amount from $2,500 to $10,000.

Status: *Chapter 708, Statutes of 2019*

AB 642 (Limón)
California Financing Law
Updates the definition of “broker” under the California Financing Law (CFL) to reflect activities that occur primarily on the internet and requires brokers to provide disclosures and obtain a consumer’s consent prior to transmitting their confidential data.

Status: Died in Senate Banking and Financial Institutions Committee

AB 1186 (Medina)
Pawnbrokers: fees and charges.
Amends the fees and charges a pawnbroker is permitted to collect.

Status: *Chapter 189, Statutes of 2019*

AB 1551 (Arambula)
Property assessments: requirements and disclosures.
Adds prohibitions and requirements related to a Property Assessed Clean Energy (PACE) assessment contract.

Status: *Chapter 156, Statutes of 2020*

AB 2196 (Gonzalez)
Pilot Program for Increased Access to Responsible Small Dollar Loans.
Extends the sunset date in the Pilot Program for Increased Access to Responsible Small Dollar Loans by five years to January 1, 2028.

Status: *Chapter 174, Statutes of 2020*

AB 2501 (Limón)
COVID-19: homeowner, tenant, and consumer relief.
Provides for temporary forbearance and affordable post-forbearance repayment options for borrowers experiencing a financial hardship due to the COVID-19 emergency, related to mortgages, motor vehicle financing, and deferred deposit transactions, as specified.

Status: Failed passage on the Assembly Floor

AB 2559 (Bauer-Kahan)
California Financing Law: enforcement and penalties.
Authorizes the Department of Business Oversight (DBO) to seek ancillary relief for consumers through administrative action related to violations of the California Financing Law.

Status: *Chapter 160, Statutes of 2020*

AB 2561 (Limón)
Consumer loans.

Prohibits state-licensed money transmitters and deferred deposit originators from arranging, making a referral, or marketing related to a loan with charges that exceed the interest rate restrictions provided by the California Financing Law.

Status: Held in Assembly Banking and Finance Committee

AB 3010 (Limón)
California Deferred Deposit Transaction Law.
Prohibits a deferred deposit originator (aka payday lender) from making a loan to a borrower who has an existing loan outstanding. Establishes a cap of four loans that can be taken out by a borrower in any 365-day period. Requires the Commissioner of Business Oversight to develop, operate, and maintain an online database to record all deferred deposit transactions for the purposes of preventing violations of the California Deferred Deposit Transaction Law.

Status: Held in Assembly Banking and Finance Committee

SB 472 (Caballero)
Wage-based, work-based, and income-based advances.
Establishes a licensing framework under the California Financing Law for wage-based and work-based advance providers.

Status: Held in Assembly Banking and Finance Committee

SB 619 (Hueso)
Promise Zones: credit reporting pilot program: educational services.
Requires landlords of large rental housing developments within a Promise Zone to report rental payment information by a tenant to a consumer reporting agency and requires the Department of Business Oversight (DBO) to contract with a third party to analyze the resulting data on tenant credit scores.

Status: Held in Assembly Banking and Finance Committee

DEBT COLLECTION

SB 187 (Wieckowski)
Rosenthal Fair Debt Collection Practices Act.
Clarifies that the definition of "consumer debt" in the Rosenthal Fair Debt Collections Practices Act (RFDCPA) includes mortgage debt. Removes the exception for attorneys in the definition of "debt collector."

Status: *Chapter 545, Statutes of 2019*

SB 908 (Wieckowski)
Debt collectors: licensing and regulation: Debt Collection Licensing Act.
Creates a new licensing law applicable to debt collectors and debt buyers, administered by the Department of Business Oversight (DBO), effective January 1, 2022.

Status: *Chapter 163, Statutes of 2020*

DEBT RELIEF

AB 699 (Grayson)
Debt collectors: licensing and regulation: Debt Collection Licensing Act.
Amends and updates the Credit Services Act of 1984 (Act) by, among other things, requiring credit services organizations (CSOs) to provide consumers with monthly itemized statements and to redact specified information in certain written communications, and creates statutory penalties for willful and knowing violations of the Act.

Status: Held in Senate Judiciary Committee

AB 2524 (Wicks)
Check Sellers, Bill Payers and Proraters Law: out-of-state activities
Deletes provisions of the Check Sellers, Bill Payers and Proraters Law that require licensees under that law to be organized under California law and that prohibit those licensees from engaging in business outside California.

Status: *Chapter 159, Statutes of 2020*

DEPARTMENT OF BUSINESS OVERSIGHT

AB 1048 (Limón)
Consumer finance protections: Department of Business Oversight: personnel.
Requires the Department of Business Oversight, upon appropriation by the Legislature, to hire specified staff to increase the department's investigations of potential cases of consumer harm, as specified.

Status: Held in Assembly Banking and Finance Committee

AB 1864 (Limón)
Financial institutions: regulation: Department of Financial Protection and Innovation.

Enacts the California Consumer Financial Protection Law (CCFPL), which provides the renamed Department of Financial Protection and Innovation (formerly, Department of Business Oversight) with oversight and enforcement authority related to providers of consumer financial products and services that are not currently under the department's authority. Prohibits unlawful, unfair, deceptive, and abusive act or practices by persons subject to the CCFPL.

Status: *Chapter 157, Statutes of 2020*

AB 2304 (Chen)
Department of Business Oversight: document charges
Reduces from 25 cents to 10 cents the amount the Commissioner of Business Oversight is authorized to charge for each page copied when the department is required to furnish a copy of a filed paper.

Status: Held in Assembly Banking and Finance Committee

SB 455 (Bradford)
Financial Empowerment Fund: unbanked and underbanked populations
Creates the Financial Empowerment Fund and authorizes the Commissioner of Business Oversight to award grants of up to $100,000 per applicant to support financial education and financial empowerment programs administered by nonprofit organizations, until January 1, 2025.

Status: *Chapter 478, Statutes of 2019*

SB 819 (Committee on Budget and Fiscal Review)
Financial institutions: regulation: Department of Financial Protection and Innovation.
Enacts the California Consumer Financial Protection Law (CCFPL), which provides the renamed Department of Financial Protection and Innovation (formerly, Department of Business Oversight) with oversight and enforcement authority related to providers of consumer financial products and services that are not currently under the department’s authority. Prohibits unlawful, unfair, deceptive, and abusive act or practices by persons subject to the CCFPL.

Status: Held in the Assembly

MISCELLANEOUS

AB 1428 (Calderon)
Business practices: prepaid credit cards: refund method.

Requires a business that offers a refund to a customer via a prepaid debit card for a purchase initiated by the customer in California, to provide the customer with at least one other method of receiving the refund other than a prepaid debit card.

Status: *Chapter 130, Statutes of 2019*

AB 2633 (Ting)
Banks: noncustodial accounts.
Prohibits a bank from denying a checking or savings account to a person because the person is a minor or from requiring that minor to provide a cosignor or guarantor as a condition of opening a checking or savings account, except as provided. Prohibits a bank from engaging in specified practices with respect to a noncustodial account, including by prohibiting a bank from charging a regular monthly fee or inactivity fee on the account or requiring the minor to provide a social security number as a condition of opening the account. Requires a bank to collect specified demographic and income information related to noncustodial accounts and to annually report that information to the Commissioner of Business Oversight. Requires the Bank on California program, administered by the Department of Business Oversight, to develop and implement a plan to improve youth financial literacy, access to financial institutions, and awareness of noncustodial accounts.

Status: Held in Assembly Banking and Finance Committee

AB 2695 (Quirk)
Banks: noncustodial accounts.
Authorizes a retailer in any sales, service, or lease transaction with a consumer to impose a surcharge on a cardholder who elects to use a credit card in lieu of payment by cash, check, or similar means, subject to two requirements. Restricts the amount of the surcharge to the lesser of the reasonable cost of the transaction to the retailer or 3.5% percent of the transaction. Requires the retailer to notify the cardholder that the retailer has elected to impose a surcharge on credit card transactions before payment is provided. Exempts specified utility payments from these provisions.

Status: Held in Assembly Banking and Finance Committee

AB 3075 (Gonzalez)
Wages: enforcement.
Requires specified business entities to include an attestation in required business filings signed by the filers that no filer has an outstanding final judgment issued by the Department of Labor Standards Enforcement for a violation of a wage order or the labor code. Establishes liability related to wages, penalties, and damages owed pursuant to a final judgment for successors, as specified.

Status: *Chapter 357, Statutes of 2020*

ACR 115 (Kamlager)
Lending to gun-related businesses.
Urges each bank with which the State of California has a business relationship to evaluate its commercial relationship with gun manufacturers and to consider the repercussions of that relationship, and urges all banks to discuss their lending practices with their shareholders and to adopt lending practices that mirror the people of California's values of protecting citizens before profit.

Status: Ordered to the inactive file in the Senate

SB 251 (Committee on Banking and Financial Institutions)
Financial institutions.
Makes technical and nonsubstantive changes to financial services and corporate securities laws.

Status: *Chapter 143, Statutes of 2019*

REAL ESTATE TRANSACATIONS

AB 412 (Quirk)
Escrow agents: asset requirements.
Allows Escrow Law licensees to exclude liabilities derived from operating lease obligations when calculating their current liabilities.

Status: Vetoed by Governor

AB 1971 (Voepel)
Reverse mortgages: waiting period.
Reduces the period that a lender must wait before accepting a final and complete application for a reverse mortgage to 3 days from the date of housing counseling.

Status: Held in Assembly Banking and Finance Committee

AB 2408 (Grayson)
Reverse mortgages: notifications.
Adds provisions to the reverse mortgage disclosure notice and checklist addressing the status of a nonborrower spouse, the effect of a borrower's death or permanent relocation from the home, and the effect of specified home improvement loans.

Status: Held in Assembly Banking and Finance Committee

AB 3151 (O'Donnell)
Escrow agents: asset requirements.
Deletes obsolete provisions related to requirements of an escrow agent licensed prior to 1992 to maintain specified amounts of tangible net worth and liquid assets in excess of current liabilities

Status: Held in Assembly Banking and Finance Committee

SECURITIES

AB 689 (McCarty)
Municipal Utility District Act: nonstock security.
Authorizes a pilot project until January 1, 2025, for the Sacramento Municipal Utility District (SMUD) to hold nonstock security in private entities.

Status: *Chapter 230, Statutes of 2019*

AB 913 (Limón)
Broker-dealers: exemptions: finders: filings.
Modifies the deadline for a finder to submit its annual renewal statement of information under the Corporate Securities Law of 1968 and gives the Commissioner of Business Oversight authority to require finders to include on that statement of information any information the commissioner reasonably determines is necessary

Status: Amended out of committee's jurisdiction subsequent to passage by the Committee

AB 2069 (Muratsuchi)
Securities transactions: qualification requirements, exemptions, and liability.
Establishes a new exemption from the qualification provisions for an offer or sale of a security for specified issuers. Requires that such an offer or sale be conducted in accordance with federal law that limits the total offering of securities to $300,000 in a 12-month period, less the aggregate offering price for all securities sold. Increases the maximum authorization amount of securities eligible to be qualified by permit via a small company application, as specified. Adds investor protections related to legal actions in cases where an issuer violates conditions of qualification by permit.

Status: Held in Banking and Finance Committee

AB 2244 (Chen)

Corporate securities: exemption from requirements.
Expands an existing exemption related to required qualification of securities issued by a cooperative corporation, if the aggregate investment of a shareholder or member in shares or memberships sold does not exceed $1,000. Specifies that this exemption applies to any credits to a member’s capital issued to a shareholder or member by a cooperative corporation, if the aggregate investment in the corporation of that shareholder or member in shares, memberships, or credits to that member’s capital sold pursuant to that provision does not exceed $1,000. Specifies that this limitation does not apply to any shares, memberships, or credits allocated to a member’s capital as all, or part of, any patronage distributions.

Status: Held in Banking and Finance Committee

AB 2637 (Limón)
Broker-dealers: exemptions: finders: filings.
Modifies the deadline for a finder to submit its annual renewal statement of information under the Corporate Securities Law of 1968 and gives the Commissioner of Business Oversight authority to require finders to include on that statement of information any information the commissioner reasonably determines is necessary

Status: Held in Assembly Appropriations Committee

STATE AND LOCAL GOVERNMENT FINANCE

AB 857 (Chiu)
Public banks.
Provides for the establishment of a public bank by a local agency, subject to approval by the Department of Business Oversight (DBO) and Federal Deposit Insurance Corporation (FDIC).

Status: *Chapter 442, Statutes of 2019*

AB 945 (McCarty)
Local government: financial affairs: surplus funds.
Increases the cap on the amount of surplus funds local agencies can invest in certain deposits and removes the January 1, 2021 sunset date on the ability to make these types of deposits.

Status: *Chapter 619, Statutes of 2019*

AB 1157 (Burke)
Time Deposit Program: report.
Requires on or before January 1, 2022, and on or before January 1 each year thereafter, the Treasurer to submit a report to the Legislature on the Time Deposit Program, as specified.

Status: Held in Assembly Appropriations Committee

AB 1176 (Bloom)
State funds: investments.
Includes as a type of security that is eligible for the investment of surplus state funds the bonds, notes, debentures, or other similar obligations of a foreign government of a country that the International Monetary Fund lists as industrialized and for which the full faith and credit of that country has been pledged for the payment of principal and interest, if specified requirements are met.

Status: Died in Assembly Banking and Finance Committee

AB 2480 (Limón)
State funds: investment: California Infrastructure and Economic Development Bank loans.
Expands the scope of securities eligible for investment by the State Treasurer to include loans issued by the California Infrastructure and Economic Development Bank for the financing of infrastructure projects by local agencies. Requires the Treasurer to target an investment of 1% of the average daily balance of the Pooled Money Investment Account in these securities.

Status: Held in Assembly Jobs, Economic Development, and the Economy Committee

AB 2851 (Bloom)
State funds: investments.
Authorizes the State Treasurer to invest state monies in bonds, notes, warrants, and other securities not in default that are the direct obligations of the government of a foreign country that the International Monetary Fund lists as industrialized and for which the full faith and credit of that country has been pledged for the payment of principal and interest, if specified requirements are met. Specifies that, for purposes of a savings and loan association or credit union being eligible to receive deposits of state funds, securities eligible to be received as security for demand and time deposits shall include all those bonds, notes, warrants, and other securities not in default that are the direct obligations of the government of a foreign country that the International Monetary Fund lists as industrialized and for which the full faith and credit of that country has been pledged for the payment of principal and interest, if specified requirements are met.

Status: Held in Assembly Banking and Finance Committee

STUDENT LOANS

AB 376 (Mark Stone)

Student loan servicing.
Prohibits specified acts and establishes specified requirements related to the servicing of student loans in a manner intended to protect student loan borrowers.

Status: *Chapter 154, Statutes of 2020*

AB 2921 (Mark Stone)
Student Loan Servicing Act: student loan accounts.
Provides a clarifying and technical amendment related to the Student Loan Servicing Act.

Status: Held in Senate Banking and Financial Institutions Committee

VIRTUAL CURRENCY/DIGITAL ASSETS

AB 953 (Ting)
Cannabis: state and local taxes: payment by digital asset.
Allows the legislative body of a city or the board of supervisors of a county to determine and implement a method by which a cannabis business may remit any city or county cannabis license tax amounts due by payment using stablecoins, as defined. Authorizes that city or county in determining that method to either accept stablecoins directly into a digital wallet controlled by that jurisdiction or to utilize a third-party digital asset payment processor that allows for the immediate conversion of any payments made by stablecoins into United States dollars and deposit into an account of that jurisdiction.

Status: Amended out of Committee's Jurisdiction

AB 1489 (Calderon)
Virtual currency businesses: regulation.
Enacts the Uniform Regulation of Virtual Currency Businesses Act. Prohibits a person from engaging in virtual currency business activity, or holding itself out as such, unless licensed or registered with the Department of Business Oversight (DBO), subject to a variety of exemptions. Prescribes requirements for licensure and examinations of these businesses and disclosures to be provided to customers. Grants DBO specified enforcement authority over these businesses, including specified civil penalties.

Status: Died in Assembly Banking and Finance Committee

AB 2150 (Calderon)
Corporate securities: limited exemption: study.
Exempts a digital asset that meets specified criteria from being deemed an investment contract within the definition of a security.

Status: Held in Senate Appropriations Committee

VICE CHAIR
CHEN, PHILLIP

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Assembly
California Legislature

ASSEMBLY COMMITTEE ON
BANKING AND FINANCE
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ASSEMBLYMEMBER, THIRTY-SEVENTH DISTRICT

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Informational Hearing of the Assembly Committee on Banking and Finance

The Consumer Financial Protection Bureau: An Examination of the CFPB under the current Federal Administration and Options for California to Better Protect its Consumers

Wednesday, March 27, 1:00 pm, Room 437

Agenda

1) Welcome and Opening Remarks

   a) **Assembly Member Monique Limón,** Chair, Assembly Banking and Finance Committee

2) Overview of the CFPB's Mission and the Bureau's Accomplishments from 2012 to 2017

   a) **Richard Cordray,** former Director of the Consumer Financial Protection Bureau

3) Payday Lending Rule

   a) **Chris Peterson,** former Special Advisor in the Office of the Director at the Consumer Financial Protection Bureau

4) Student Loan Borrowers

   a) **Seth Frotman,** former Student Loan Ombudsperson at the Consumer Financial Protection Bureau

5) Enforcement

   a) **Suzanne Martindale,** Consumer Reports

   b) **Sharon Velasquez,** Greenlining Institute

   c) **Kat Taylor**, founder of Beneficial State Bank

6) Public Comment

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Informational Hearing
Assembly Banking and Finance Committee

An Examination of the Consumer Financial Protection Bureau under the current Federal Administration and Options for California to Better Protect its Consumers

Wednesday, March 27, 2019
1:00 pm, Room 437

1. **Hearing Goal.** The goal of this hearing is to provide information to members of the Legislature about the state of federal consumer financial protection policies under the current administration. The hearing will also provide opportunities for witnesses to share their analysis and recommendations related to options for California to provide better protection of its consumers. Witnesses will provide testimony about specific areas of concern, including payday lending practices, the servicing of student loans, and enforcement of existing law.

2. **The Beginnings of the Consumer Financial Protection Bureau (CFPB).** The CFPB is a U.S. government agency that makes sure banks, lenders, and other financial services companies treat consumers fairly. Institutions subject to the CFPB's supervisory authority include banks, credit unions, mortgage originators and servicers, payday lenders, and private student loan lenders, as well as the larger participants in other consumer financial markets, such as: consumer reporting, debt collection, student loan servicing, international money transfer, and automobile financing. In most cases, the CFPB establishes a minimum standard of protections, and states can layer on additional protections as they see fit.

   The CFPB was created in response to the failure of existing regulatory agencies leading up to the financial crisis of 2007-08. The pre-crisis federal regulatory framework had two primary flaws related to consumers. First, regulatory responsibilities were dispersed over a patchwork of agencies, including the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), the Office of Thrift Supervision, the Office of the Comptroller of the Currency (OCC), the Federal Trade Commission (FTC), and others. These regulatory agencies did not coordinate well with one another and failed to stop risky lending practices that ultimately led to the subprime meltdown. Second, these regulatory agencies relied heavily on the perspective of their own staff who were embedded within the financial services companies that they regulated. This close tie between regulators and the regulated companies led to a significant degree of regulatory capture, where the regulators' perception of industry behavior was heavily influenced by the industry itself. No single regulatory agency was both focused on outcomes for consumers and empowered with sufficient enforcement authority to police the markets, which resulted in harm to millions of consumers due to the industry's reckless behavior.

   In 2010 Congress passed and President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act in response to the subprime mortgage meltdown and subsequent financial crisis. Within the Dodd-Frank Act, Congress authorized the creation of the Consumer Financial Protection Bureau. U.S. Senator Elizabeth Warren has been widely credited with proposing the CFPB during the subprime crisis, although similar consumer-focused financial regulatory bodies had been

discussed previously. In September 2010, President Obama named Warren as Special Advisor to the Secretary of the Treasury and charged her with setting up the new agency. In January 2012, President Obama appointed Richard Cordray as Director of the CFPB.

3. **How the CFPB protects consumers.** Through legislation and subsequent rulemaking, the federal government consolidated existing authorities that had been scattered throughout other regulatory agencies and established new authorities, making the CFPB the single, consumer-focused regulating authority at the federal level. These laws gave the CFPB an array of tools to promote fair, transparent, and competitive markets. The CFPB's responsibilities can be organized into three general categories: education, enforcement, and research.

   Education: The CFPB develops and distributes financial education materials to consumers to help them make financial decisions that are in their best interest. In order for financial markets to be fair and transparent, consumers must have the tools to compare costs, benefits, and risks between products. Examples of the CFPB's successes in this area include the Know Before You Owe mortgage disclosure that can be used to compare loan estimates, a database that allows consumers to compare credit card agreements, and a series of guides for major financial decisions, including buying a house, getting an auto loan, paying for college, and planning for retirement.

   Enforcement: The CFPB is the cop on the beat when it relates to consumer financial protection laws. The Bureau is responsible for rule-making, supervision, and enforcement of federal consumer financial laws, as well as broad and flexible rulemaking authority to define and prohibit unfair, deceptive, or abusive acts or practices. Under Mr. Cordray's leadership, the CFPB put $12 billion back in the pockets of families through enforcement and supervision activities. Some of the largest enforcement cases include a $2 billion penalty against Ocwen for mortgage servicing violations, including fraudulent foreclosures; a $747 million penalty against Bank of America for illegal credit card practices; a $700 million penalty against Citibank for illegal credit card practices; and $480 million in debt relief for students related to predatory lending practices by Corinthian College.

   Research: The CFPB conducts extensive research on consumer behavior and monitors financial markets for new risks to consumers. The Bureau hosts a large complaint database to better understand the challenges consumers face and to identify and track illegal behavior by financial services companies. The Bureau's research informs how other divisions undertake their work: data and findings are used to make decisions about rule-making, research informs how the Bureau develops educational materials and disclosures to be most effective for consumers, and market monitoring and complaint tracking identify potential abusive activities that lead to enforcement actions.

4. **The CFPB under the current federal administration.** Congressional Republicans have almost uniformly opposed the existence of the CFPB from its inception. After the 2016 Presidential Election, the new administration was immediately antagonistic to Mr. Cordray's leadership. Mr. Cordray's term as Director was scheduled to end in the summer of 2018, but Mr. Cordray decided to leave the CFPB in November 2017.

   The President appointed Mick Mulvaney as Interim Director in November 2017. While in Congress, Mulvaney said, "I don't like the fact that CFPB exists," and as interim director, Mulvaney tried to undermine the independence of the CFPB by giving Congress and the President more power over

the Bureau's actions and personnel. While Mulvaney and Congressional Republicans were not successful in making statutory changes to the CFPB, Mulvaney and his successor, Kathy Kraninger, have severely constrained the agency from within. Upon his appointment, Mulvaney hired a dozen political appointees to the lead the CFPB offices, and they have significantly damaged the Bureau's ability to protect consumers. The major rollbacks include:

- *Severe drop in enforcement cases* – Publicly announced enforcement actions dropped about 75 percent from the average in recent years, according to a Washington Post analysis of bureau data. This drop occurred despite consumer complaints rising to new highs.
- *The "Mulvaney discount"* – For enforcement cases that were permitted to go forward, Mulvaney approved penalties that were far below the recommendation of career regulators. In one case, an enforcement attorney recommended an $11 million fine for a lender that improperly pressured consumers to buy insurance and accosted borrowers at the home and jobs to collect on debts. A political appointee slashed the penalty by more than half. In another case, enforcement attorneys sought a settlement that would have returned $60 million to consumers after a debt collection company impersonated law enforcement officers while collecting debts. The Mulvaney appointee scrapped the recommendation to return money to consumers and levied a paltry $800,000 fine on the company instead.
- *Proposed gutting of the Payday Lending Rule* – In November 2017, the CFPB finalized the Payday Lending Rule which would have required payday lenders to establish a consumer's ability-to-repay before giving them a loan. This underwriting requirement was designed to ensure that consumers do not fall into a cycle of reborrowing that leaves them worse off than when they sought the initial loan. The CFPB conducted a five-year process of empirical research, meeting with stakeholders, and adjusting its initial proposal that was released in June 2016.

  The rule was scheduled to go into effect January 2018, but Mulvaney delayed the rule. In February 2019, the new Trump-appointee at the top of the Bureau, Kathy Kraninger, announced that the Bureau was proposing to remove the ability-to-repay requirement, essentially gutting the rule to the liking of the payday lending industry. The Bureau is currently accepting comments on the proposed rollback. If the Bureau moves forward with the proposal, it will likely be challenged in courts as an "arbitrary and capricious" action under the Administrative Procedure Act.
- *Eliminated enforcement authority for discrimination cases* – Mulvaney stripped the Office of Fair Lending and Equal Opportunity of its enforcement authority. This office was charged with identifying instances of discrimination by financial services companies. Prior to Mulvaney, the office brought some of the CFPB's most high-profile cases, including a settlement against a bank for racial discrimination against minority mortgage borrowers. It also brought a case against an automobile lender that systemically charged black, Hispanic, and Asian American customers more for auto loans than whites who were equally creditworthy.

- *Shut down the Office of Students and Young Consumers* – Mulvaney shut down a key watchdog division focused on protecting student loan borrowers from abuses by loan servicers, debt collectors, and predatory lenders. Subsequent to the office's closure, the Bureau has taken no meaningful action to protect student loan borrowers, and the former head of the office, Seth Frotman, resigned in August 2018, citing "the Bureau has abandoned the very consumers it is tasked by Congress with protecting."
- *Stopped examining lenders for compliance with Military Lending Act* – Internal documents obtained by The New York Times in August 2018 revealed that the CFPB under Mulvaney's direction ceased examinations of financial companies to ensure their compliance with the Military Lending Act (MLA). The MLA restricts lenders from charging more than 36% APR on consumer loans to active duty military members and their dependents. The MLA was passed with strong bi-partisan support in 2006 and signed into law by President George W. Bush. The Department of Defense and dozens of military and veterans groups opposed Mulvaney's decision, but the CFPB has yet to change its position.

5. **California regulates and enforces some consumer financial protections.** Two state agencies conduct a large majority of consumer financial protections in California: the Department of Business Oversight (DBO) and the Department of Justice (DOJ).

   DBO serves at the state's primary regulator of financial services companies. Industries under the DBO's regulation include state-chartered banks and credit unions, non-depository lenders, residential mortgage lenders, mortgage loan originators, payday lenders, check sellers, money transmitters, student loan servicers, PACE program administrators, broker-dealers and investment advisers, among several others. Consistent with authorities of other state bank supervisors, DBO has the authority to revoke the licenses of regulated actors for bad behavior. DBO also has a variety of enforcement tools to punish bad actors and, in some cases, can seek compensation on behalf of consumers for wrongdoing. In recent years, DBO has increased its enforcement efforts, particularly against small-dollar lenders. DBO identifies potential cases of unlawful activity through consumer complaints and through routine examinations of licensed entities.

   DOJ, under the leadership of the Attorney General, has broad enforcement authority to leverage state and federal laws against financial services providers that engage in unfair, deceptive, or unlawful business practices. In recent years, the DOJ has successfully brought cases for unlawful wire fraud scams, mortgage abuses by large Wall St. banks, abusive debt collection practices, and predatory and unlawful practices by for-profit colleges and student loan servicers.

Consumer Financial Protection in California

Testimony to California Assembly Committee on Banking and Finance
March 27, 2019

Richard Cordray

Thank you for inviting me to testify today. My name is Richard Cordray, and I had the honor to serve as the founding Director of the U.S. Consumer Financial Protection Bureau for its first six years. My testimony concerns how California can take the initiative to protect consumers in the financial marketplace at a time when the Federal government is retreating from this area. It will touch on theories of financial regulation; the purpose, role, and current status of the CFPB; how federalism affects consumer finance; and the rationale for California to step up and enhance its own capability to protect consumers. California has always prided itself on being a leader in looking out for consumers, and it has the chance to do so again here.

Financial regulation is enormously important for consumers, who often feel frustrated and mistreated in the financial marketplace. The problems they face at a personal level are magnified throughout the economy. The last two generations have seen an explosion of consumer debt, which has risen from about $1,000 per person to more than $40,000 per person today. The mass availability of consumer credit has created new opportunities for people but also increases the risks they face, and the risks to our economy. Exotic lending in the mortgage market brought down the entire American economy in 2008, costing millions of jobs, millions of homes, and trillions in lost retirement savings. The regulators lacked the tools to monitor the consumer markets effectively and missed the tell-tale signs. In the end, they were too late to stop the financial crisis from turning into the Great Recession.

In the wake of that catastrophe, which turned out to be worldwide in scope, a chorus of experts called for an overhaul of financial regulation. They converged on the "twin peaks" theory, which has been broadly accepted as the right approach for the 21st century. It imposes a distinct separation between the first peak of financial stability, where prudential regulators assure the stability of the financial companies, and the second peak of financial conduct, where other regulators are responsible for consumer protection. This approach creates efficiency by having the same regulator oversee the conduct of both chartered banks and other financial companies, which often compete with one another in the same markets, such as mortgage and auto lending. The separation of the two main functions is also essential to prevent one of these goals from subordinating the other. In a 20th-century model, the missing focus was consumer protection. We neglected our oversight of the conduct of the financial companies, and it cost all of us dearly, including 40 million Californians. The Great Recession also brought on a deep fiscal crisis in California that has only recently been healed.

In the past decade, most large Western economies have adopted the twin peaks model: Australia, New Zealand, the U.S., the U.K., Ireland, and South Africa. Others are progressing toward the same destination. But right now, California is still operating on the obsolete model with its built-in conflict of interest between promoting the safety and soundness of financial companies versus regulating how they treat consumers. The two goals are sometimes at odds, and the financial regulator depends in part for its funding on dues paid by those companies. That is not the right answer for a state as important as California, which now boasts the fifth largest economy in the world. For these reasons, Californians deserve a modernized structure with a more concentrated focus on consumer financial protection.

At the federal level, the CFPB was created to fulfill this role. In less than a decade, it has proved to be a great success. It has amplified the voices of consumers, receiving and handling over 1.6 million complaints since it opened its doors. It has enforced the law vigorously, returning $12.4 billion to more than 30 million Americans, which works out to about a billion dollars for Californians alone. Its reforms to the mortgage and credit card markets have saved consumers billions of dollars per year, putting a halt to the irresponsible and predatory lending that brought on the financial crisis, damaged our economy, and hurt so many Americans. It also has reined in harassing debt collectors, forced improvements to the credit reporting companies, and stopped many sloppy or abusive practices by auto lenders and student loan servicers.

Right now, the CFPB has been retreating from some of its responsibilities under its new leadership. It has backed away from a strong federal rule on payday lending, from actions to prevent violations of the Military Lending Act, and from aggressive oversight of student loan servicers. I am aware that you are going to hear more about these issues from other panelists who are expert in these areas and will discuss them in more detail. But this is the perfect time for California to step forward to shore up consumer financial protection, even as the Trump administration is currently defaulting on some of its obligations under federal law.

The financial reform law that created the CFPB, known as the Dodd-Frank Act, expressly provided for more expansive protections at the state level that can go beyond federal protections. To put it simply, the law says clearly that federal law sets a floor, not a ceiling, on consumer financial protection in this country. Congress thus opened the door for more vigorous protection of consumer rights through state officials who can ensure that these laws are strong and that they are enforced effectively. These efforts not only protect consumers – who simply deserve to be

treated fairly by financial companies – but it also levels the playing field by protecting more ethical companies from having to compete against bad actors that are willing to cut corners and violate the law to get an advantage in the market. That is the worst form of unfair competition, and stronger enforcement of consumer laws can help root it out.

We also need to do a better job of educating consumers about the risks and challenges of more complicated credit products. Over the past decade, many consumers have been exposed to the hazards of mortgage instruments with increasingly exotic features; they now have access to revolving credit, often on multiple credit card accounts with different interest rates and vastly different terms; and they may be juggling various other credit obligations as well. Yet nobody would claim that this country is suddenly doing a better job of educating consumers about their obligations – not in the home, not in school, not at work, and nowhere else. That is a task we need to take much more seriously than we now do or have done. By taking the initiative, California can help lead other states forward.

This work matters greatly in our society, which is marked by growing income inequality and huge wealth inequality. The focus on putting more money into people's pockets should be matched by a similar focus on keeping more money in their pockets, rather than having it drain away in nickel-and-dime fees, frauds and scams, or abuses that may be perpetrated by big financial companies. In a simpler time, Benjamin Franklin declared in his *Poor Richard's Almanac* that "a penny saved is a penny earned." In today's world, a penny saved from financial predators is a penny that is very well earned indeed. A single bad financial experience can ruin a person or a family, and a constellation of bad experiences can undermine entire communities, as we saw in the runup to the financial crisis just a decade ago.

In 1962, President Kennedy gave a speech to Congress in which, for the first time, he spoke directly about the role of the consumer in our society. He noted that: "Consumers, by definition, include us all. They are the largest economic group in the economy . . . Two-thirds of all spending in the economy is by consumers. But they are the only important group in the economy who are not effectively organized, whose views are often not heard." His words are just as true today. The push to protect consumers later resulted in such landmark bipartisan legislation as the Truth in Lending Act, the Equal Credit Opportunity Act, and the Fair Debt Collection Practices Act, enacted under both Republican and Democratic administrations. Thirty years later, these efforts at the federal level had fallen behind the rapid pace of developments in the financial marketplace. The laws needed to be updated, and an outmoded regulatory structure meant that the laws were being systematically under-enforced, with grave consequences for all Americans. The CFPB was an essential and welcome centerpiece of those reforms. As the federal government now again seems to be abdicating its role, it is crucial for this country that the states are taking up the mantle of consumer financial protection. I am encouraged to see that California is prepared to lead the way.

Thank you. I would be glad to answer any questions you may have.

Prepared Testimony of Seth Frotman
California Assembly Committee on Banking and Finance
The Consumer Financial Protection Bureau:
An Examination of the CFPB under the current Federal Administration and Options for California to Protect its Consumers
Sacramento, CA
March 27, 2019

Chairwoman Limón. Vice Chairman Chen. Members of the Committee. Thank you so much for the honor of testifying here today.

This is my second time testifying before the California legislature. I was last here in 2017 as California became one of the first states in the country to take the critical step of overseeing the student loan market.[1]

But as I sit here today, the breadth of the challenges that consumers face across this state and this country loom larger; the risks more significant; the harms more severe. The threats—even from those serving in power—are tangible. The allies are scarce.

And with that, the seriousness and scope of this state's collective response—and the centrality of this committee in that response—more critical. The deep, systemic reforms—more necessary.

The financial futures of tens of millions of citizens across this state rest in the balance.

There is perhaps no better demonstration of this precarious position than through the lens of the student debt crisis going on right outside these walls. Because I can think of no more apt example that conveys the urgency of the requisite action than what has happened across the student loan market in just these past two years.

- $143 billion in student debt has been added nationally—now borrowers collectively owe more than $1.5 trillion in outstanding student loans;[2]
- More than half a million people have been forced to take on student debt—now there are more than 44 million Americans getting a student loan bill each month.[3]
- $3,000 dollars have been added to borrowers' balances—now student loan borrowers owe, on average, more than $35,000 in student debt.[4]
- More than a quarter of a million older borrowers have brought nearly $19 billion of student debt into their retirement years—now 3.2 million seniors owe more than $85 billion in student debt.[5]

- And, in the 24 months since I was last here, two million borrowers have defaulted on their student loans—now 8.5 million student loan borrowers across the country are in default.[6]

And across California, the picture is equally bleak.

- 3.8 million Californians owe more than $134 billion in student loan debt.[7]
- Nearly half a million of these borrowers live in rural communities across California, and more than 80,000 of these borrowers are at least three payments behind.[8]
- Over 300,000 of California's seniors owe student loan debt, many of which are having their Social Security benefits offset because their loans are in default.[9]

But this is more than numbers. This is the pain of forcing a parent to choose between groceries or making her student loan payment.[10] This is the pain of forcing a neighbor to choose between his medicine or his debt.[11] This is the pain of living amidst another crisis.[12]

By holding this hearing today, this Committee has again taken a major step in recognizing that California is in a crisis. But more importantly, by holding this hearing today, this Committee has recognized its power to help end it.

From this perspective, the story of the student debt crisis and California's response is a lesson in the power of public policy to improve student loan borrowers' lives. But more than that, it can create a roadmap for how the government oversees all of consumer finance. It can provide the blueprint for California to build an oversight framework that matches the complexity and nefariousness of a financial sector that seems to know no bounds.

The Student Debt Crisis

The student debt crisis—both in California and across the country—is about more than debt loads and ballooning balances. It is about more than higher education policy and college affordability. The student debt crisis is a significant—perhaps the *most* significant—consumer finance issue threatening our nation at this time.

We have dropped a trillion dollars of debt on the backs of American families with little thought to the oversight, consumer protection, or accountability that is necessary to manage it.

We encouraged millions of students to take on billions in debt. And then, to add insult to injury, we sent them into a market with a piecemeal consumer protection framework that buckled under the weight of this historic burden. We continue to ignore the risks that

pervade this market and the harms inflicted upon millions of borrowers who are falling through its cracks.

From student loan servicers[13] to for-profit schools,[14] from debt collectors[15] to private student lenders,[16] from private equity firms[17] to debt relief scams[18]—entire industries have built their profit models around taking advantage of student loan borrowers. Their practices collectively add billions of dollars of additional student debt to household balance sheets, damaging the financial future of an entire generation.[19]

Throughout America, big banks and small scams hurt millions of borrowers at every single point of their financial lives—from the day a student receives her first bill until the day she pays off her last loan.

- Student loan servicers are doling out millions in executive compensation while arguing that they have no responsibility to the very borrowers they are paid to serve;[20]
- Private student lenders with business practices that would make payday lenders blush are casually making non-dischargeable loans they know are going to fail;[21]
- Banks are setting up shop on campuses to prey on students—leeching overdraft fees from the financial aid of the most vulnerable;[22]
- Social media companies are driving revenue for investors by pushing scam ads that tout fake "student loan debt relief" to the most desperate borrowers;[23]
- Companies that exist solely to manipulate outcomes for the poorest-performing schools are committing illegal practices that keep the taxpayer spigot flowing;[24]
- Debt collectors and collection lawyers are manipulating the court system in order to garnish borrowers' wages and destroy consumers' credit.[25]

And sadly, this is only a mere glimpse.

Tens of millions of student loan borrowers nationally, and millions right here in California, are trapped in a broken system.

The Consumer Financial Protection Bureau

If you are chasing the American dream, you should not be ripped off at every turn.

Almost a decade ago, that was the vision for the Consumer Financial Protection Bureau—a federal agency with the tools, resources, and resolve to stand up for the 260 million consumers in this country.[26]

From mortgages to money orders.[27] From credit cards to credit reporting.[28] From prepaid cards to payday loans.[29] And of course, student loans.[30]

Across all of these markets, the Consumer Bureau had one mission—protect consumers.

And in nowhere was this mission more important than in the student loan market—a market where, prior to the CFPB, any notion of oversight came from the Department of Education—the self-described “largest special purpose consumer bank in the world.”[31]

In effect, lawmakers placed a trillion-dollar bet on the prospect that a giant creditor could be trusted to self-police. They wagered the financial futures of millions of students, and those students lost.

Student loan borrowers needed a watchdog that was not tainted by its role as a creditor and contract administrator. They needed a watchdog that was not trying to push dollars out the door. They needed a watchdog that was not sending out mixed messages prompted by perverse incentives.

The CFPB could fill this role because its mission was clear—protect consumers.

Furthermore, it did not define success as simply fixing the system for the next person. The CFPB was an agency focused on helping the people that were already struggling—on getting justice for borrowers who had already been ripped off.

It recognized that that what plagues higher education finance is not limited to some small set of actors; that the problem is not limited to one sector of schools; that it was not merely dealing with outliers in an otherwise benevolent system.

The CFPB was an independent agency that utilized every authority bestowed upon it by Congress—from supervision to enforcement, from documenting complaints to helping individual consumers.

- It helped servicemembers and disabled veterans.[32]
- It helped teachers, nurses, cops, and firefighters.[33]
- It helped borrowers in all 50 states and every US territory.[34]
- It helped borrowers of every age, every race, every gender.[35]
- It helped American families.[36]

STUDENT BORROWER PROTECTION CENTER

The Bureau oversaw all aspects of the market, from banks to nonbanks, lenders to servicers. It took enforcement action against those who broke the law, from small scammers to large financial institutions like Wells Fargo, Discover, and Navient.[37]

And it worked. In those seven years, the CFPB returned more than $750 million to student loan borrowers.[38]

But when the formerly independent CFPB was placed under the political influence of Mick Mulvaney, Kathy Kraninger, and their appointees, everything changed. The CFPB walked away from the 44 million Americans with student debt.

Where the CFPB once stood proudly as the most vocal and vehement champion for student loan borrowers, it is now willfully absent.

- In the 16 months since Director Cordray left, there has not been a single enforcement action announced against a student loan company.
- In those 16 months, there has not been a single effort to expose the rampant breakdowns borrowers face across the student loan market.
- In those 16 months, there has not been a single for-profit school, a single bank, a single company held to account for the harm inflicted on vulnerable student loan borrowers.
- In those 16 months, the Bureau has prioritized the wishes of the most powerful financial companies in America over the needs of the very people they were tasked by Congress to protect, all under the selective invocation of "statutory restraint."[39]

And after public testimony by Director Kraninger just this month, it is now clear that the CFPB has broken its promise to prioritize rooting out discrimination in the student loan market.[40] In fact, it appears that the Bureau has ceased supervising the $1.2 trillion federal student loan market at all.[41] Instead, a once-independent agency now waits for a permission slip from the Department of Education before it does its job—before it does the very work it was tasked by Congress to do.

The CFPB has made the dangerous decision to cave to the U.S. Department of Education—the same Department that, under Betsy DeVos, has used every opportunity to place corporations above consumers—from the rolling back of responsible regulations to filling positions of power with industry insiders.[42] The Education Department slammed shut courthouse doors on borrowers ripped off by predatory players.[43] It illegally delayed borrower protections that were the result of years of negotiation at every level of government.[44] It rolled back accountability for predatory schools that leave borrowers with mounds of debt and worthless degrees.[45] And then, in

an effort to take away the last avenue of recourse, the Department has tried to block states from protecting their own residents.[46]

But the problem is broader than the CFPB; it is broader than the Department of Education. The entire federal government has not only turned its back on student loan borrowers—it is now aggressively arming the other side. Just last year, the Justice Department brazenly marched into federal and state court houses arguing that student loan companies are above the law.[47] In 2016, the Federal Communications Commission rolled back protections that prevented student loan borrowers from getting harassed on their cell phones.[48]

The message is clear—there is no white knight. The federal government is not going to ride to the rescue. There is no cavalry on the horizon.

That is why today's hearing matters. That is why this Committee matters. That is why state consumer protection matters.

California Must Act

For more than a hundred years, the American financial system has recognized the critical role that states play in overseeing financial markets.[49] The foundational premise of any state's police power is the ability to oversee the general well-being of its citizens. That includes the power to oversee the companies responsible for the financial futures of those citizens. As the United States Supreme Court has stated, [quote] "banking and related financial activities are of profound local concern. . . . [S]ound financial institutions and honest financial practices are essential to the health of any State's economy and to the well-being of its people."[50]

The impact of student debt on the lives and livelihoods of borrowers is unimpeachable.

Research shows that student loan borrowers are less likely to buy homes,[51] start families,[52] and save for retirement.[53] They are less likely to start businesses or serve their communities.[54] But the impact doesn't end there—it ripples across neighborhoods, across communities, and across the state.

With $130 billion affecting nearly four million people across California, there are few markets as consequential to the well-being of this state than the student loan market.[55] Research now shows the effects of student debt on communities and the economy—including stymying asset accumulation,[56] driving income, racial, and gender inequality,[57] and preventing residents from establishing long-term ties to their communities.[58]

And when the student loan market fails, communities struggle. And the student loan market has already failed.

Communities struggle as needless defaults cause their public colleges to risk missing key metrics that are crucial to their funding.[59] They struggle as their residents fall behind in critical credit markets and find fewer economic and job opportunities.[60] They struggle as fewer licensed professionals are eligible to serve in high-demand fields.[61] They struggle as their aging populations have less financial security.[62]

Taking action to protect student loan borrowers is necessary to the health of your nearly $3 trillion economy.[63] It is necessary to the well-being of your nearly 40 million citizens.[64] It is necessary to the well-being of your families, your neighborhoods, and your communities. It is necessary to the well-being of California.

And that is why California must continue to lead the way.
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For years, California has been a national leader in the fight for student loan borrowers' rights.

In 2016, California passed Assemblymember Stone's Student Loan Servicing Act. This law provided a key building block for this state to engage in meaningful oversight and root out illegal practices that plague the student loan industry.[65]

In 2018, Attorney General Becerra sued Navient, one of the largest student loan servicers in the country, for hurting every type of borrower, with every type of loan, at every stage of repayment.[66]

And now, the groundbreaking new legislation introduced by Assemblymember Stone will make California the first state in the nation to give student loan borrowers the same kind of strong, enforceable rights long provided to consumers with mortgages and credit cards.

For the millions of Californians trapped in a broken student loan system, Assemblymember Stone's Student Borrower Bill of Rights also brings real accountability to a student loan industry responsible for ripping off borrowers at every turn. This bill bans abuses by the student loan industry—ensuring that companies can no longer get rich by doing business on the cheap, by cutting corners and cheating borrowers out of their rights.

It also establishes a new California Student Borrower Advocate to help individuals when they run into trouble. And it creates the first-ever public "report card" for the student loan industry—ensuring regulators, lawmakers, and the public can spot emerging risks to borrowers.

My organization, the Student Borrower Protection Center, was honored to join with NextGen and Consumer Reports to co-sponsor AB 376. We applaud Assemblymember

Stone for his continued leadership and stand ready to serve as a partner and an ally as the California Legislature advances this critical legislation in the weeks and months ahead.

Diligent supervision. Proactive enforcement. Deliberate rulemaking. Smart data collection. And a deep commitment to demanding answers when consumers ask for help. These are the measures that this bill will implement—the same measures that made the Consumer Financial Protection Bureau a fierce ally for consumers.

These critical reforms offer a path forward for student loan borrowers, and also for all Californians.

Because consumer finance affects more than student loan borrowers. It's all people who are left behind because of a broken system. It's the single mother who can no longer provide for her kid. It's the family who can no longer keep a roof over its head. It's the servicemember who can no longer defend her country—because they were each ripped off at every turn, but never saw justice.

California families are facing significant challenges that demand significant solutions—solutions that can match the seriousness and scale of the harm perpetrated across the market.

The California Consumer Bureau

As you have already heard from Director Cordray and Professor Peterson, and what I am sure you are currently hearing from your constituents, is that people need your help. Millions of people in this state need your help.

As the former Assistant Director of the Office for Young Consumers, I heard directly from a generation borne of the financial crisis—a generation forced to endure challenges that the prior generation had never fathomed. Challenges that continue to leave millions of consumers barely able to keep their heads above water, while large segments of this generation simply drown

- The rate of young consumers behind on their car loans has hit record levels as they are continually left out of a growing labor market;[67]

- They are among those hit hardest by overdraft fees that send their finances spiraling;[68]

- One-in-three millennials have used a payday loan, sending them into the vicious cycle of debt;[69]

- And as homeownership rates among African Americans remain alarming low compared to their white peers, we know that borrowers of color, especially young borrowers of color, disproportionately struggle in the mortgage market.[70]

An entire generation is being preyed upon by a financial system seeking to strip them of their wealth before they ever have a chance to earn it. They are being knocked down, again and again, before they can ever stand up.

But the problems are not limited to young consumers. For four years, I had the honor of working for Holly Petraeus in the Office for Servicemember Affairs. I traveled to dozens of states, including California. I heard from servicemembers down in San Diego at the Marine Corps Recruit Depot about the financial predators that line up outside the gates of installations like “bears at a trout stream.”[71] I talked with veterans groups about mortgage products targeting those who wore the uniform, rivaling the worst practices we saw during the financial crisis.[72] I met with California’s Adjutant General and heard tales of how military consumers are targeted by schemes from pension advances to predatory loans.[73]

But it’s not just young people. It’s not just servicemembers. The stakes are so much bigger. At stake is the future of the American dream and the character of our country—whether the American dream we all recognize—a house to raise our family, a car to get to work, a college education to give our kids a better life—will be the province of a select few; while the rest have their money stolen at every turn, or worse, face denials and discrimination based on factors like race or sex. Whether we live in a just and equitable society where the American dream is open and accessible to all who seek it, or whether that America is reserved only for a select few.

Consumer finance matters because the American dream matters. To young people. To servicemembers. To all consumers—to the 30 million across California and the 260 million across America.[74]

People are not buying a house in cash, cutting a check to pay for their car or paying for their children’s full college tuition with what they have in their savings accounts. They rely on credit—and a well-functioning credit market—to accomplish each of these goals.

That is why consumer protection matters. That is why a California Consumer Bureau matters.

A California Consumer Bureau can do what the federal government lacks the authority to do.

A California Consumer Bureau can push other states, the federal government, and everyone else to do better.

A California Consumer Bureau can stand up when the federal government falls down.

But let me be clear—this isn't just about having a backstop for when times are bad. This isn't just about Donald Trump. This is about creating a long-lasting legacy that can stand up for consumers regardless of who sits in the White House. This is about having a mechanism to push the status quo forward even when our allies sit behind the resolute desk. This is about a legacy that recognizes that the collective fate of 40 million Californians' lives should not live and die by what happens on the first Tuesday, following the first Monday, every fourth November.

And so, as this Committee undertakes the important and necessary work of crafting a California Consumer Bureau, I would like to offer some observations that—after seven and half years at the CFPB—I know to be true:

- **First, complaints are a critical component of consumer-driven reform.** The CFPB gave power to American consumers by giving them the ability to raise their hand and say, "this isn't right!" Over a million consumers were helped through the CFPB's complaint portal.[75] And more importantly, the CFPB looked at those million complaints and recognized that those were not isolated incidents. It knew that for every consumer who complained about being ripped off, ten more sat silent despite being harmed. But through that one complaint, the CFPB could help all of them.

  For six years, these complaints were the foundation of the CFPB's work, leading to real reform across markets. These complaints drove the prioritization of supervision and enforcement. They drove the research and analysis underpinning rulemaking. They drove strategic inter- and intragovernmental efforts. Through a million complaints, the CFPB was able to help tens of millions of people.

  The California Consumer Bureau can do more than replicate this approach—it can improve upon it. Institutions, regardless of size or structure, should be statutorily required to engage in a robust complaint resolution process, where substantive answers to consumers' questions are mandated and guidelines around "resolution" are clearly articulated. Furthermore, the California Consumer Bureau should enshrine in statute the power of public access to complaints. Public access to individual consumer experiences, including maximum possible detail around borrowers' complaints, should be required by law. This information—including company responses—should be shared as widely as possible across both federal and California's law enforcement channels to ensure strategic coordination in tackling market breakdowns.

- **Second, distinct populations can bring unique insight.** Consumer-driven reform is not limited to complaints. The designers of the CFPB realized that

special populations interact with consumer financial markets in unique ways, and with that often comes unique problems. From the Office for Young Consumers to the Office for Servicemember Affairs to the Office for Older Americans—dedicating resources to understanding the problems and experiences of these populations was a key to the CFPB's success. Further, their challenges often served as the "canary in the coalmine"—when they faced breakdowns in their financial lives, it signaled emerging risks at a company or across an entire industry.[76]

A California Consumer Bureau can do the same thing. The state of California has two million servicemembers and veterans, seven million senior citizens, and five million credit invisibles.[77] The California Consumer Bureau can house dedicated offices for each population, serving as an external outreach mechanism that creates an avenue for these populations to engage with the Bureau.

These offices can also serve as drivers of policy change. They can coordinate the work of offices across the California Consumer Bureau—aligning oversight, enforcement, research, rulemaking, and more to ensure that everyone is working in the interest of these constituencies.

A California Consumer Bureau can also make sure that the uniquely diverse populations of this state are represented—an Office for New Americans, an Office for Rural Affairs, and an Office for Financial Inclusion. Furthermore, the California Consumer Bureau should be adaptable to address the needs of emerging populations not yet contemplated to guarantee that the agency's policy perspectives—and subsequent actions—remain responsive to the entire state.

- **Third, markets should be defined by who needs protection, not what a product is called or whether an institution takes deposits.** One of the most significant lessons of the crisis was that all financial institutions, regardless of structure, need robust and comprehensive oversight if we wish to counter the deep-seated, intrinsic consumer harm that plagues the market. That lesson is as true now as it was then. We have seen how banks like Wells Fargo can rip millions of people off without them ever knowing.[78] But we have also seen how nonbank financial service providers can harm people to the tune of billions of dollars.[79]

  The structure of the CFPB was unique in that it recognized that consumers' financial lives do not fit neatly into categories like "bank" and "nonbank." Nor are consumers' lives organized by the type of product they are using. Any meaningful effort to systemically reform the consumer finance market must necessarily share this perspective.

And those who created the CFPB rejected the idea of determining the scope of the Bureau's authority based on these artificial lines. In order to empower the CFPB to fulfill its mission of protecting consumers, they could not define jurisdiction through easily evaded definitions of product or narrow demarcations of covered entities. Instead, they gave the agency the ability to take action against the full range of players in the market.

However, the California Consumer Bureau has the opportunity to go beyond the CFPB, where political influence outweighed consumer harm and excluded entire markets from oversight. Lawmakers should not let lobbyists draw arbitrary lines exempting markets or market participants. Additionally, lawmakers need not limit the scope of the agency's oversight based out of political concern over a specific tier of financial institutions while ignoring the risks these entities may pose. While recognizing where preemption will preclude certain measures, lawmakers should not limit the California Consumer Bureau before it even opens its doors. Only by giving the California Consumer Bureau the broadest range of authorities to oversee all markets, for all institutions of all sizes will it have the power to protect consumers across their entire financial lives.

- **Fourth, consumer protection laws should be consolidated at a single agency, ensuring regulators can translate lessons across markets.** One of the most powerful things the Dodd-Frank Act did was to consolidate the most essential consumer protection laws under one roof.[80] From the Truth in Lending Act to the Equal Credit Opportunity Act, from the Fair Debt Collection Practices Act to the Fair Credit Reporting Act, the CFPB administers a wide range of laws to ensure that consumers were protected. Congress also bestowed upon the CFPB broad authority to stamp out unfair, deceptive, and abusive practices across the market.[81] With respect to each of these laws, the CFPB has rulemaking and supervisory authority. The CFPB also shares enforcement authority with state attorneys general, state banking departments and, in some cases, other federal regulators.

  A California Consumer Bureau should enjoy the same range of authorities in order to hold companies accountable for the same range of harm. A California Consumer Bureau should incorporate these statutes by deeming any violation of any law under CFPB jurisdiction as a violation of California state law.

  But a California Consumer Bureau could go further. It could recognize additional protections not incorporated as enumerated statutes under Dodd-Frank but which are still essential to protecting consumers, like the Military Lending Act or the Servicemembers Civil Relief Act.[82] A California Consumer Bureau should also protect consumers from being harassed on their cell phones or from being harmed by a predatory small business loan.

And more importantly, a California Consumer Bureau can stand up when the federal government fails. Californians should not be subjected to discrimination in the credit market simply because Mick Mulvaney and other Washington officials are more in tune to the needs of K Street than the continuing struggles of communities of color. California should ensure that its statutes—from state fair lending to state consumer protection law—are stronger. Statutes should explicitly contain the critical mechanisms needed to hold companies accountable when they cause disparate harm to vulnerable communities.

Furthermore, California should create mechanisms, where appropriate, to allow municipalities and private individuals to enforce key protections and become an equal partner in protecting consumers.

- **And most importantly, having access to the full toolbox is critical if you want to fix a broken consumer finance market.** From complaints to supervision, from enforcement to rulemaking, having the full panoply of tools to hold bad actors accountable for conduct is the most important part of creating an effective Consumer Bureau. The premise and genius of the CFPB was the recognition that providing one agency with the full range of policy interventions on behalf of consumers and allowing it to select the most effective and efficient means to protect them was the best way to prevent another financial crisis.

  And specifically, Congress gave the CFPB the authority to write rules to ban specific unfair, deceptive, and abusive acts and practices wherever they occur, as long as the company committing predatory acts falls under the agency's jurisdiction. In effect, this gives the agency the ability to take what it learns from supervision, from consumer complaints, from research, and from enforcement and apply these insights to set standards. It lets a Consumer Bureau be nimble by allowing each of its tools to work in concert to effectively regulate an entire industry or market.

  This should be the guiding principle for a California Consumer Bureau. It should have the full range of tools necessary to tackle the harm borrowers face across the financial market—tools that can operate independently and are not predicated on the use of another.

  Parallel, or even overlapping, mechanisms of accountability should not be dismissed as duplicative or superfluous. Instead, they should be considered critically important to the effective protection of consumers.

Conclusion

In closing, I would like to address some of the common retorts I know you will hear as you undertake this ambitious agenda on behalf of the people you serve. Some will tell

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you that you cannot act, or that this is not what state governments do. Some will say that your aspirations are too great and that you must accept the status quo.

They will say that this is the work of the federal government and suggest that states must always play second fiddle.

They will tell you to tamper your ambitions and expectations of what is possible.

They are wrong.

They are wrong because they do not understand this unique moment in time. They do not understand the will of this Committee or of this Assembly to act. Of California to act.

To act to offer a different path than what is being offered 3,000 miles away. One that puts people above special interests. One that stands up for borrowers' rights. One that understands that the well-being of this state—of this nation—is premised on protecting its consumers with the full range of authorities it has. One that is willing to break the hold of special interests and overcome inertia and inaction.

They are wrong because we know that this Committee will stand up. It will stand up for the 30 million people chasing the American dream. It will stand up for this state and show that there is a much different path.

Thank you.

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[1] *See Prepared Remarks of Seth Frotman Before the California State Senate Banking and Financial Institutions Committee* (Mar. 22, 2017), https://files.consumerfinance.gov/f/documents/201703_cfpb_Frotman-Testimony-CA-Senate-Banking-Committee.pdf.

[2] *See* Fed. Res. Bd., *Consumer Credit – G.19* (Mar. 7, 2019), https://www.federalreserve.gov/releases/g19/current/default.htm.

[3] Between Q4 2015 and Q4 2017, the number of student loan borrowers increased by 536,400. As of Q4 2017, there were 44.7 million student loan borrowers. *See* Fed. Res. Bank of N.Y., *2016 Student Loan Update* (2016), https://www.newyorkfed.org/medialibrary/interactives/householdcredit/data/xls/sl_update_2016.xlsx; Fed. Res. Bank of N.Y., *2018 Student Loan Update* (2018), https://www.newyorkfed.org/medialibrary/interactives/householdcredit/data/xls/sl_update_2018.xlsx.

[4] Based on SBPC's analysis of Fed. Res. Bank of N.Y., *2018 Student Loan Update* (2018), https://www.newyorkfed.org/medialibrary/interactives/householdcredit/data/xls/sl_update_2018.xlsx.

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[5] Based on SBPC's analysis of Fed. Res. Bank of N.Y., *2018 Student Loan Update* (2018), https://www.newyorkfed.org/medialibrary/interactives/householdcredit/data/xls/sl_update_2018.xlsx.

[6] *See* U.S. Dep't of Educ., *Federal Student Loan Portfolio*, https://studentaid.ed.gov/sa/about/data-center/student/portfolio (last visited Mar. 3, 2018); U.S. Dep't of Educ., *Federal Perkins Loan Program Status of Default as of June 30, 2016* (June 12, 2017), https://ifap.ed.gov/perkinscdrguide/1516PerkinsCDR.html.

[7] *See* U.S. Dep't of Educ., *Portfolio by Location* (Sept. 30, 2018), https://studentaid.ed.gov/sa/sites/default/files/fsawg/datacenter/library/Portfolio-by-Location.xls; Fed. Res. Bank of N.Y., State Level Household Debt Statistics 2003-2018 (Mar. 2019), https://www.newyorkfed.org/medialibrary/Interactives/householdcredit/data/xls/area_report_by_year.xlsx.

[8] Based on SBPC's analysis of U.S. Dep't of Educ., *Portfolio by Location* (Sept. 30, 2018), https://studentaid.ed.gov/sa/sites/default/files/fsawg/datacenter/library/Portfolio-by-Location.xls and Fed. Res. Bank of Phila., *Consumer Credit Explorer* (2018), https://www.philadelphiafed.org/eqfx/webstat/index; *see also* PJ Tabit & Josh Winters, *"Rural Brain Drain": Examining Millennial Migration Patterns and Student Loan Debt*, Fed. Res. Consumer & Cmty. Context (Jan. 2019), https://www.federalreserve.gov/publications/files/consumer-community-context-201901.pdf.

[9] *See* Consumer Fin. Prot. Bureau (CFPB), *Older consumers and student loan debt by state* (Aug. 2017), https://files.consumerfinance.gov/f/documents/201708_cfpb_older-consumers-and-student-loan-debt-by-state.pdf; *see also* U.S. Gov't Accountability Office (GAO), GAO-17-45, Social Security Offsets: Improvements to Program Design Could Better Assist Older Student Loan Borrowers with Obtaining Permitted Relief (Dec. 2016), https://www.gao.gov/assets/690/681722.pdf.

[10] *See, e.g.*, Me. Ctr. for Econ. Policy, *Student Lending Reform* 4 (Nov. 2018) https://www.mecep.org/wp-content/uploads/2018/11/MECEP-CRL-Student-Loans-and-Lending-Poll-November-2018.pdf.

[11] *See, e.g.*, *id.* at 6; *see also* CFPB, *Snapshot Of Older Consumers And Student Loan Debt* 13 (2017), https://files.consumerfinance.gov/f/documents/201701_cfpb_OA-Student-Loan-Snapshot.pdf ("The Bureau's analysis of survey data shows that older consumers with outstanding student loans are more likely than those without outstanding student loans to report that they have skipped necessary health care needs such as prescription medicines, doctors' visits, and dental care because they could not afford it.")

[12] *See generally* Seth Frotman, *Broken Promises: How Debt-financed Higher Education Rewrote America's Social Contract and Fueled a Quiet Crisis*, 2018 Utah L. Rev. 4 (2018), https://dc.law.utah.edu/ulr/vol2018/iss4/1/.

[13] *See, e.g.*, CFPB v. Navient Corp., No. 3:17-cv-00101-RDM (M.D. Pa. 2018) (stating "Navient's compensation policies for its customer service representatives have incentivized them to push numerous borrowers to forbearance without adequately exploring income-driven repayment plans with those borrowers, and in some cases, without even mentioning income-driven repayment plans at all."); Complaint at 11, California v. Navient Corp., No. CGC-18-567732 (2018) (stating "Navient's compensation policies for customer service representatives incentivized this misconduct."); Complaint at 13, Mass. v. Pa. Higher Educ. Assistance Agency, No. 1784-cv-02682 (2017) (". . . PHEAA has wrongfully held borrowers' money that it was not entitled to collect."); Complaint at 18, Wells Fargo Bank, N.A., CFPB No. 2016-CFPB-0013 (Aug. 22, 2016) at 9 (Respondent . . . maximized late fees incurred by many consumers . . .); Office of N.Y. Att'y Gen., *Attorney General James And Superintendent Vullo Announce $9 Million Settlement Of Federal Student Loan Servicing Claims With*

Acs Education Services (Jan. 4, 2019), https://ag.ny.gov/press-release/attorney-general-james-and-superintendent-vullo-announce-9-million-settlement-federal.

[14] *See, e.g.*, Complaint at 10, CFPB v. Corinthian Colleges, Inc., No. 14-4194 (N.D. Ill. 2014) (stating "Regardless of whether students were able to repay the private student loans, Corinthian would profit from the increased availability of Title IV monies."); Complaint at 26, CFPB v. ITT Educational Services, Inc., No. 1:14-cv-292 (S.D. Ind. 2014) (stating "While ITT remains profitable—it reaped approximately $59 million in net income during 2013—former ITT students, having been coerced by ITT into the ITT Private Loans, face a high likelihood of defaulting."); Bridgepoint Education, Inc., CFPB No. 2016-CFPB-0016 (Sept. 9, 2016); Complaint, California v. Ashford University, LLC, No. RG17883963 (2017); U.S. v. Educ. Mgmt. Corp., No. 07-461 (W.D. Pa. 2011); U.S. Dep't of Justice, *For-Profit College Company to Pay $95.5 Million to Settle Claims of Illegal Recruiting, Consumer Fraud and Other Violations* (Nov. 16, 2015), https://www.justice.gov/opa/pr/profit-college-company-pay-955-million-settle-claims-illegal-recruiting-consumer-fraud-and; M.D. Att'y Gen., *AG Frosh:$1.4 Million in Loans Forgiven for Nearly 1,000 Maryland Students* (Nov. 16, 2015), http://www.marylandattorneygeneral.gov/Press/2015/111615.pdf.

[15] *See, e.g.*, Complaint at 45, CFPB v. Navient Corp., No. 3:17-cv-00101-RDM (M.D. Pa. 2017) ("Pioneer's false promises that rehabilitation would remove all adverse information regarding the borrowers' loans from their credit reports."); Minn. Commerce Dep't, *Minnesota Commerce Department announces action against improper student loan debt collections* (Aug. 11, 2017), https://mn.gov/commerce/media/news/?id=17-307713 ("Minnesota Commerce [Department] . . . and regulators in four other states have reached a $500,000 joint settlement with two subsidiaries of iQor Holdings Inc. for improper debt collection practices, including making abusive and harassing phone calls to increase student loan payments."); Complaint at 70, Ill. v. Navient Corp., No. 17-CH-00761 (Jan. 18, 2017) (". . . ...Pioneer Credit Recovery, and General Revenue Corporation's unfair and deceptive debt collection practices."); Transworld Systems, Inc., CFPB No. 2017-CFPB-0018 (Sept. 18, 2017), https://files.consumerfinance.gov/f/documents/201709_cfpb_transworld-systems_consent-order.pdf ("In support of many of these lawsuits, [Transworld] executed affidavits that falsely claimed personal knowledge of the account records and the consumer's debt, and, in many cases, personal knowledge of the chain of assignments establishing ownership of the loans.").

[16] *See, e.g.*, Complaint at 10, Wash. v. Navient Corp., No. 17-2-01115-1 SEA (2017) ("From 2006-2007 Sallie Mae claimed 42% of the private student loan market by pursuing an unfair and deceptive subprime lending strategy of providing expensive subprime loans to vulnerable borrowers even though Sallie Mae knew many — even most — of those loans would default."); Consent Judgment, CFPB v. Nat. Collegiate Master Student Loan Trust, No. 1:17-cv-01323-UNA (Del. 2017); Discover Bank, CFPB No. 2015-CFPB-0016 (July 22, 2015), https://files.consumerfinance.gov/f/201507_cfpb_consent-order-in-the-matter-of-discover-bank-student-loan-corporation.pdf; Citibank, N.A., CFPB No. 2017-CFPB-0021 (Nov. 21, 2017), https://files.consumerfinance.gov/f/documents/cfpb_citibank-n.a._consent-order_112017.pdf.

[17] *See, e.g.*, CFPB, *CFPB Takes Action Against Aequitas Capital Management for Aiding Corinthian Colleges' Predatory Lending Scheme* (Aug. 17 2017), https://www.consumerfinance.gov/about-us/newsroom/cfpb-takes-action-against-aequitas-capital-management-aiding-corinthian-colleges-predatory-lending-scheme; Or. Dep't of Justice, *AG Rosenblum Announces $192 Million Aequitas Settlement; $2.1 Million for Oregon Students* (Aug. 17, 2017), https://www.doj.state.or.us/media-home/news-media-releases/ag-rosenblum-announces-192-million-aequitas-settlement-2-1-million-oregon-students; *see also* Charlie Eaton, Sabrina Howell & Constantine Yannelis, *When Investor*

Incentives and Consumer Interests Diverge: Private Equity in Higher Education, (Nat. Bureau of Econ. Res. (Aug. 2018), https://www.nber.org/papers/w24976.

[18] *See, e.g.*, CFPB, *CFPB Takes Action to Shut Down Illegal Student Debt Relief Scheme* (Mar. 15, 2016), https://www.consumerfinance.gov/about-us/newsroom/cfpb-takes-action-to-shut-down-illegal-student-debt-relief-scheme; Complaint, CFPB v. IrvineWebWorks, Inc., No. 8:14-cv-1967 (C.D. Cal. 2014); Wash. Att'y Gen., *AG Ferguson Surpasses $1 Million in Student-Borrower Recoveries* (Jan. 5, 2017), https://www.atg.wa.gov/news/news-releases/ag-ferguson-surpasses-1-million-student-borrower-recoveries ("Since November 2015, Ferguson has brought lawsuits or resolved allegations against 15 out-of-state student loan adjusters for violating Washington's Debt Adjustment Act and Consumer Protection Act by charging illegal fees for debt adjusting and ignoring legal obligations to inform customers of important rights."); FTC, *FTC, State Law Enforcement Partners Announce Nationwide Crackdown on Student Loan Debt Relief Scams* (Oct. 13, 2017), https://www.ftc.gov/news-events/press-releases/2017/10/ftc-state-law-enforcement-partners-announce-nationwide-crackdown.

[19] *See, e.g.*, Complaint at 23, CFPB v. Navient Corp., No. 3:17-cv-00101-RDM (M.D. Pa. 2017) (stating "At the conclusion of those forbearances, Navient had added nearly four billion dollars of unpaid interest to the principal balance of their loans.").

[20] *See, e.g.*, Memorandum of Law in Support of Defendants' Motion to Dismiss at 20, CFPB v. Navient Corp., No. 3:17-cv-00101-RDM (M.D. Pa. 2017) (stating that "the servicer acts in the lender's interest… and there is no expectation that the servicer will 'act in the interest of the consumer.'"); *see also* Shahien Nasiripour, *Student Debt Giant Navient to Borrowers: You're on Your Own*, Bloomberg (Apr. 3, 2017), https://www.bloomberg.com/news/articles/2017-04-03/student-debt-giant-navient-to-borrowers-you-re-on-your-own.

[21] *See, e.g.*, Complaint at 10, Wash. v. Navient Corp., No. 17-2-01115-1 SEA (2017) ("From 2006-2007 Sallie Mae claimed 42% of the private student loan market by pursuing an unfair and deceptive subprime lending strategy of providing expensive subprime loans to vulnerable borrowers even though Sallie Mae knew many — even most — of those loans would default.").

[22] *See, e.g*., CFPB, *Student banking* 9-21 (Dec. 2016), https://files.consumerfinance.gov/f/documents/2016_cfpb_student_banking_report.pdf (where the Bureau included a section on the "high cost account fees and aggressive marketing" used by banks with college-sponsored accounts.).

[23] *See, e.g.*, *Letter from CFPB Asst. Director Rohit Chopra to Google Vice President Susan Molinari* (June 22, 2015), https://www.cfpbmonitor.com/wp-content/uploads/sites/5/2015/06/Google.pdf; Kate Knibbs, *Inside the "Obama Student Loan Forgiveness" Scams*, The Ringer (Feb. 7, 2017), https://www.theringer.com/2017/2/7/16037256/inside-the-obamas-student-loan-forgiveness-scams-8112c06728d4.

[24] *See, e.g.*, U.S. Gov't Accountability Office, GAO-18-163, *Federal Student Loans: Actions Needed to Improve Oversight of Schools' Default Rates* (Apr. 2018), https://www.gao.gov/assets/700/691520.pdf.

[25] *See, e.g*., CFPB, *CFPB Takes Action Against National Collegiate Student Loan Trusts, Transworld Systems for Illegal Student Loan Debt Collection Lawsuits* (Sept. 18, 2017), https://www.consumerfinance.gov/about-us/newsroom/cfpb-takes-action-against-national-collegiate-student-loan-trusts-transworld-systems-illegal-student-loan-debt-collection-lawsuits/.

[26] *See* Elizabeth Warren, *Unsafe at Any Rate*, Sum. 2007 Democracy J. 5 (2007), https://democracyjournal.org/magazine/5/unsafe-at-any-rate/.

[27] *See* 12 C.F.R. § 1003 (2015); 12 C.F.R. § 1026 (2013); 12 C.F.R. Part 1090 (2014).

[28] *See* 12 C.F.R. Part 1026 (2013); 12 C.F.R. Part 1090 (2012).

[29] *See* 12 C.F.R. § 1026 (2016); 12 C.F.R. § 1041 (2017).

[30] *See* 12 C.F.R. Part 1090 (2013).

[31] Stephanie Eidelman, *ED Data Shows 109% Increase in Student Loan Defaults Over Last 4 Years; Says Small Businesses Can Handle*, InsideARM (May 28, 2018), https://www.insidearm.com/news/00044012-ed-data-shows-109-increase-student-loan-de (quoting former FSA Chief Operating Officer Wayne Johnson as stating "The FSA Student Loan Program represents the equivalent of being the largest special purpose consumer bank in the world.").

[32] *See, e.g.*, CFPB, *CFPB Statement On Department of Defense Military Lending Act Final Rule* (July 21, 2015), https://www.consumerfinance.gov/about-us/newsroom/cfpb-statement-on-department-of-defense-military-lending-act-final-rule; Rohit Chopra & Holly Petraeus, *Veterans: Take advantage of student loan forgiveness, but don't let it damage your credit*, CFPB (Nov. 17, 2014), https://www.consumerfinance.gov/about-us/blog/veterans-dont-let-student-loan-forgiveness-damage-your-credit; CFPB, *CFPB Sues Nation's Largest Student Loan Company Navient Failing Borrowers at Every Stage of Repayment* (Jan. 18, 2017), https://www.consumerfinance.gov/about-us/newsroom/cfpb-sues-nations-largest-student-loan-company-navient-failing-borrowers-every-stage-repayment (...[T]he Bureau charges that Navient . . . [h]armed the credit of disabled borrowers, including severely injured veterans.").

[33] *See, e.g.*, CFPB, *CFPB Spotlights Borrower Complaints About Student Loan Servicers Mishandling Public Service Loan Forgiveness Program: Consumer Bureau Launches "Certify Your Service" Campaign to Help Teachers, First Responders, and Other Public Servants Stay on Track* (Jun. 22, 2017), https://www.consumerfinance.gov/about-us/newsroom/cfpb-spotlights-borrower-complaints-about-student-loan-servicers-mishandling-public-service-loan-forgiveness-program/.

[34] *See* CFPB, *50 state snapshot of student debt* (Oct. 2017), https://files.consumerfinance.gov/f/documents/cfpb_student-loans_50-state-snapshot_complaints.pdf.

[35] *See, e.g.*, CFPB, *Fair Lending Report of the Consumer Financial Protection Bureau* (Apr. 2017), https://files.consumerfinance.gov/f/documents/201704_cfpb_Fair_Lending_Report.pdf; CFPB, *Snapshot Of Older Consumers And Student Loan Debt* 14 (2017), http://files.consumerfinance.gov/f/documents/201701_cfpb_OA-Student-Loan-Snapshot.pdf.

[36] *See* Christopher L. Peterson, *Consumer Financial Protection Bureau Law Enforcement: An Empirical Review*, 90 Tulane L. Rev. 1057 (2016), https://dc.law.utah.edu/cgi/viewcontent.cgi?article=1051&context=scholarship; Consumer Federation of Am., *CFPB Shutters Student Protection Unit That Returned $750 Million to Consumers* (May 9, 2018), https://consumerfed.org/press_release/cfpb-shutters-student-protection-unit-that-returned-750-million-to-consumers.

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[42] *See* Julie Margetta Morgan, *Who Pays? How Industry Insiders Rig the Student Loan System—and How to Stop It*, Roosevelt Institute (June 2018), http://rooseveltinstitute.org/wp-content/uploads/2018/06/How-Industry-Insiders-Rig-the-Student-Loan-System.pdf.

[43] *See* Andrew Kreighbaum, *Few Solutions for Defrauded Borrowers*, Inside Higher Ed (June 26, 2017), https://www.insidehighered.com/news/2017/06/26/advocates-say-department-inaction-forced-arbitration-leave-defrauded-borrowers-bind.

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[45] *See* Andrew Kreighbaum, *For-Profits Keep Access to Billions in Aid*, Inside Higher Ed (Aug. 13, 2018), https://www.insidehighered.com/news/2018/08/13/dropping-gainful-employment-means-profits-keep-billions-student-aid.

[46] *See* Glenn Thrush, *After Scaling Back Student Loan Regulations, Administration Tries to Stop State Efforts*, N.Y. Times (Sept. 6, 2018), https://www.nytimes.com/2018/09/06/us/politics/devos-student-loans.html.

[47] *See* Statement of Interest of the United States, Student Loan Servicing Alliance v. Taylor, 1:18-CV-0640 (D.D.C. 2018); *but see* Brief of Amici Curiae of States of N.Y, et al., Student Loan Servicing Alliance v. Taylor, 1:18-CV-0640 (D.D.C. 2018).

[48] Section 301 of the Bipartisan Budget Act authorized the FCC to adopt rules to "restrict or limit the number and duration" of any wireless calls "to collect a debt owed to or guaranteed by the US." The FCC set forth its rules in a 2016 Report and Order, the effective date of which would have been 60 days following approval by the Office of Management and Budget. These regulations never went into effect. *See* Fed. Commc'n Comm'n, FCC 16-99, *In the Matter of Rules and Regulations Implementing the Telephone Consumer Protection Act of 1991* (Aug. 11, 2016).

[49] *See* Alejandro Komai & Gary Richardson, *A Brief History of Regulations Regarding Financial Markets in the United States: 1789 to 2009* at 4, NBER Working Paper 17443 (Sept. 2011), https://www.nber.org/papers/w17443.pdf.

[50] Lewis v. BT Inv. Managers, Inc., 447 U.S. 27, 38 (1980).

[51] *See, e.g*., Meta Brown & Sydnee Caldwell, *Young Student Loan Borrowers Retreat from Housing and Auto Markets*, Fed. Res. Bank of N.Y.: Liberty Street Econ. (Apr. 17, 2013), https://libertystreeteconomics.newyorkfed.org/2013/04/young-student-loan-borrowers-retreat-from-housing-and-auto-markets.html (illustrating the potential for lost asset accumulation opportunities, homeownership rates of 30-year-old student loan borrowers decreased by more than 5 percent compared with homeownership rates of 30-year-old non-borrowers); Fed. Res. Bank of N.Y., *Press Briefing On Household Debt, With Focus On Student Debt* 36–47 (Apr. 3, 2017), https://www.newyorkfed.org/medialibrary/media/press/PressBriefing-Household-Student-Debt-April32017.pdf (finding that college attendees with student debt have lower homeownership rates than college attendees without student debt and that higher debt balances are associated with lower home ownership rates).

[52] *See, e.g.*, Jessica Dickler, *Student loan debt is a hurdle for many would-be mothers*, CNBC (May 22, 2018), https://www.cnbc.com/2018/05/22/student-loan-debt-is-a-hurdle-for-many-would-be-mothers.html.

[53] *See, e.g.*, CFPB, *Snapshot Of Older Consumers And Student Loan Debt* 14 (2017), http://files.consumerfinance.gov/f/documents/201701_cfpb_OA-Student-Loan-Snapshot.pdf (reporting that borrowers nearing retirement “had a lower median amount in their employer-based retirement account or an Individual Retirement Account (IRA) than consumers without student loan debt”); Joseph Egoian, *73 Will Be the Retirement Norm for Millennials*, NerdWallet (Oct. 23, 2013), https://www.nerdwallet.com/blog/investing/73-retirement-norm-millennials (finding that a 4 year college graduate with median student loan debt of $23,000 has about $115,000 less in retirement savings than a 4 year college graduate with no student loans by the time they reach age 73).

[54] *See, e.g.*, Brent W. Ambrose et al., *The Impact of Student Loan Debt on Small Business Formation* (Mar. 31, 2014), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2417676; Brandon Busteed, *Student Loan Debt: Major Barrier to Entrepreneurship*, Gallup (Oct. 14, 2015), https://news.gallup.com/businessjournal/186179/student-loan-debt-major-barrier-entrepreneurship.aspx.

[55] *See* U.S. Dep’t of Educ., *Portfolio by Location* (Sept. 30, 2018), https://studentaid.ed.gov/sa/sites/default/files/fsawg/datacenter/library/Portfolio-by-Location.xls; Fed. Res. Bank of N.Y., State Level Household Debt Statistics 2003-2018 (Mar. 2019), https://www.newyorkfed.org/medialibrary/Interactives/householdcredit/data/xls/area_report_by_year.xlsx.

[56] *See, e.g*., Meta Brown & Sydnee Caldwell, *Young Student Loan Borrowers Retreat from Housing and Auto Markets*, *supra* note 28; *see generally* William Elliot & Melinda Lewis, *Student Debt Effects on Financial Well-Being: Research and Policy Implications*, 29 J. Econ. Surveys 614 (2015), http://onlinelibrary.wiley.com/doi/10.1111/joes.12124/full (finding that student loan debt can delay asset accumulation for years and can decrease a family’s net worth by 63 percent).

[57] *See* Richard Fry, *Young Adults, Student Debt, and Economic Well Being* (2014), http://www.pewsocialtrends.org/2014/05/14/young-adults-student-debt-and-economic-well-being/ (“showing that millennials who incur debt after graduation have an average net worth of seven times less than that of their non-indebted counterparts. Millennials with no debt when graduating have an average net worth of $64,700, while millennials graduating with student debt have only $8,700 on average.”). Additional research shows that an average student debt load ($53,000) for a dual-headed household with bachelor’s degrees from four-year universities leads to a wealth loss of nearly $208,000. Robert Hiltonsmith, *At What Cost? How Student Debt Reduces Lifetime Wealth* (2013), http://www.demos.org/sites/default/files/imce/AtWhatCostFinal.pdf; Fed. Res. Bank of Bos., Daniel Cooper & J. Christina Wang, *Student Loan Debt and Economic Outcomes* (2014),

https://www.bostonfed.org/-/media/Documents/Workingpapers/PDF/economic/cpp1407.pdf. Furthermore, women and borrowers of color are disproportionately affected by student debt. *See* American Association of University Women, *Women's Student Debt Crisis in the United States*, http://www.aauw.org/research/deeper-in-debt (showing that on average, women have higher student loan balances than men); CFPB, *The significant impact of student debt on communities of color* (Sep. 15, 2016), https://www.consumerfinance.gov/about-us/blog/significant-impact-student-debt-communities-color ("Student loan borrowers of color are more likely to attend for-profit colleges and face unique obstacles while completing a degree. Data shows that over 90 percent of African-American and 72 percent of Latino students leave college with student loan debt, compared to 66 percent of white students and 51 percent of Asian-American students. Upon entering repayment, research suggests higher rates of student loan defaults and delinquencies in zip codes populated primarily by minorities with higher income levels and education."); Emily Rauscher & William Elliott, *The Relationship between Income and Net Worth: A Virtuous Cycle for High but Not Low Income Households*, Journal of Poverty 20(4): 380-395 (2016) (finding that a college graduate with an extra $10,000 in student loans will achieve the nation's median net worth 26 percent slower than a college graduate without that debt , and concluding that financing higher education through student loans can put college graduates who begin school with few assets even further behind their wealthier peers.).

[58] Alvarro Mezza, Daniel Ringo & Kamila Sommer, *Can Student Loan Debt Explain Low Homeownership Rates for Young Adults*? at 5, Fed. Res. Consumer & Cmty. Context (Jan. 2019), https://www.federalreserve.gov/publications/files/consumer-community-context-201901.pdf; PJ Tabit & Josh Winters, *"Rural Brain Drain": Examining Millennial Migration Patterns and Student Loan Debt*, Fed. Res. Consumer & Cmty. Context (Jan. 2019), https://www.federalreserve.gov/publications/files/consumer-community-context-201901.pdf.

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[60] *See, e.g.*, Brent W. Ambrose et al., *The Impact of Student Loan Debt on Small Business Formation* (Mar. 31, 2014), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2417676; Brandon Busteed, *Student Loan Debt: Major Barrier to Entrepreneurship*, Gallup (Oct. 14, 2015), https://news.gallup.com/businessjournal/186179/student-loan-debt-major-barrier-entrepreneurship.aspx.

[61] *See* Nick Sibilia, *Defaulting on a student loan could cost you your job in these professions*, NBC News (Aug. 28, 2018), https://www.nbcnews.com/think/opinion/defaulting-student-loan-could-cost-you-your-job-these-professions-ncna904476.

[62] *See* CFPB, *Snapshot of older consumers and student loan debt* (Jan. 2017), http://files.consumerfinance.gov/f/documents/201701_cfpb_OA-Student-Loan-Snapshot.pdf

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[73] *See, e.g.*, David Lazarus, *'Pension advance' company is unmasked*, Los Angeles Times (Mar., 14, 2017), 'Mhttps://www.latimes.com/business/lazarus/la-fi-lazarus-cfpb-future-income-payments-20170317-story.html; Joel Hoffmann, *Companies target military pensions*, The San Diego Tribune (Nov. 3, 2014), https://www.sandiegouniontribune.com/news/watchdog/sdut-military-pension-advances-predatory-lending-2014nov03-htmlstory.html; Nora Dowd Eisenhower & Holly Petraeus, *Consumer advisory: 3 pension advance traps to avoid*, CFPB (Mar. 16, 2015), https://www.consumerfinance.gov/about-us/blog/consumer-advisory-3-pension-advance-traps-to-avoid; Cal. Att'y Gen. Xavier Becerra, *Attorney General Xavier Becerra Sues For-Profit Ashford University for Defrauding and Deceiving Students* (Nov. 29, 2017), https://oag.ca.gov/news/press-releases/attorney-general-xavier-becerra-sues-profit-ashford-university-defrauding-and ("Ashford University preyed on veterans and people of modest means.").

[74] *See* Fed. Res. Bank of N.Y., *Quarterly Report on Household Debt and Credit, 2018:Q4* (Feb. 2019), https://www.newyorkfed.org/medialibrary/interactives/householdcredit/data/pdf/HHDC_2018Q4.pdf.

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[76] *See generally* CFPB, *Written Testimony of Rohit Chopra before the Committee on the Budget* (June 4, 2014), https://www.consumerfinance.gov/about-us/newsroom/written-testimony-of-rohit-chopra-before-the-committee-on-the-budget/.

[77] As of December 2018, there were 215,877 active duty and national guard/reserve military personnel in California. *See* U.S. Dep't of Defense, Number of Military and DoD Appropriated Fund (APF) Civilian Personnel Permanently Assigned (Dec. 31, 2018), https://www.dmdc.osd.mil/appj/dwp/rest/download?fileName=DMDC_Website_Location_Report_1812.xlsx&groupName=milRegionCountry. As of 2016, there were more than 1.78 million veterans living in California. *See* U.S. Dep't of Veterans Affairs, *Table 6L: Vetpop2016 Living Veterans By State, Age Group, Gender, 2015-2045* (2016), https://www.va.gov/vetdata/docs/Demographics/New_Vetpop_Model/6L_VetPop2016_State.xlsx. According to the 2017 Census, there were more than 7.2 million senior citizens (60+) in California. *See* U.S. Census Bureau, *American Fact Finder:* Population 60 Years and Over in The United States (2017), https://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=ACS_17_5YR_S0102&prodType=table. According to a 2018 CFPB report, there are more than 5 million "credit constrained" individuals in California. *See* CFPB, California Cmty. Credit Profile (Aug. 31, 2018), https://files.consumerfinance.gov/f/documents/bcfp_credit-profiles_california.pdf.

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[79] *See, e.g.*, Complaint at 23, CFPB v. Navient Corp., No. 3:17-cv-00101-RDM (M.D. Pa. 2017) (stating "At the conclusion of those forbearances, Navient had added nearly four billion dollars of unpaid interest to the principal balance of their loans.").

[80] *See, e.g.*, Consumer Reports, *Prof. Elizabeth Warren on why we need the CFPB, Part 1* (Aug. 12, 2009), https://www.consumerreports.org/cro/news/2009/08/prof-elizabeth-warren-on-why-we-need-the-cfpa-part-1/index.htm ("A Consumer Financial Protection Agency will bring complex and sometimes contradictory consumer regulations under one roof and transform them into a coherent set of smarter rules. The CFPA would put someone in Washington—someone with real power—who cares about consumers and has expertise on consumer finance issues. This will help steer us out of the current crisis and also prevent future crises.").

[81] 12 U.S.C. § 1002(12).

[82] *See also* A.B. 3212, 2017-18 Sess. (Cal. 2018).

Written Testimony of Suzanne Martindale
Senior Policy Counsel, Consumer Reports
Before the
California Assembly Banking & Finance Committee

The Consumer Financial Protection Bureau: An Examination of CFPB under the current Federal Administration and Options for California to Better Protect its Consumers

March 27, 2019

Thank you, Chair Limon and members of the committee for the opportunity to testify today. My name is Suzanne Martinale, Senior Policy Counsel in the West Coast Office of Consumer Reports, formerly known as Consumers Union.

After the 2008 financial crisis, we worked very hard with our coalition partners to lobby for the creation of the CFPB. Since it opened its doors, we have engaged on a regular basis with the CFPB to provide information and policy recommendations, as well as engage with staff at public hearings and stakeholder meetings around the country.

We have seen what the CFPB can do when it brings to bear all of the tools given to it under the Dodd-Frank Act, to discharge its important mission of protecting consumers - us, regular people! - in a financial marketplace that can be complex, confusing, and rife with problematic industry actors.

I want to kick off this portion of the hearing to suggest how we should conceptualize the task ahead - as we identify highlights from the CFPB's tenure to date, and how they can guide us as we consider our options for improving oversight of the financial industry in California.

This panel is ostensibly about enforcement. Now, there are two ways we can talk about "enforcement." In the narrower sense, there are the tools of investigation and litigation for bringing discrete actions - as we already do through our existing agencies. For example, the CA AG is suing Navient for servicing practices that have exacerbated borrowers' struggles to repay their student loans; and the Department of Business Oversight just took action last week against auto title lender Fast Money, seeking to revoke their lending license and void their loan contracts due to allegations of illegal charges and deceptive marketing practices.

But there's another, broader way to talk about "enforcement" that includes all the additional tools my co-panelists have already highlighted - such as supervision, research and market monitoring, complaint handling, and public engagement - that can help inform an agency's decision about how to act in order to stop bad behavior and protect consumers.

Therefore, as we discuss what a California consumer protection framework could look like, we need to identify the broader tools that create the *conditions of possibility* for smart and diligent enforcement.

The CFPB's unique structure and authorities can offer rich lessons for us, as we determine where we already have those capacities at the state level, and where we could use additional capacities or improvements.

To begin conducting this inquiry - which will be challenging, and incredibly important to get right - it will be helpful to center ourselves around a few "north star" concepts that have surfaced throughout witness testimonies today: (1) comprehensive and (2) coordinated mechanisms for enforcement.

- Comprehensive: a unified vision for financial industry oversight, focused on relevant activities more so than charter or business type, with a full suite of tools to achieve the best outcomes;
- Coordinated: processes that encourage information sharing and collaboration both within the divisions of a particular agency, as well as across agencies when appropriate, to leverage resources and maximize impact.

Before the CFPB came into existence, we did not have a comprehensive and coordinated national framework for protecting consumers in the financial marketplace - and it enabled all kinds of abuses that went unchecked. We had banking agencies focused mostly on supervision for safety and soundness, not so much on rulemaking or enforcement. We had agencies focused mostly on enforcement and some rulemaking (e.g., FTC or DOJ), but without supervision powers. And then we had agencies ill-equipped to apply a consumer protection lens to a problem where such a lend was increasingly needed - exhibit A, the Dept of Education.

The 2008 financial crisis provided a wake-up call, and spurred efforts to look anew at our federal financial oversight framework. The CFPB's resulting structure reflects Congress' intent to establish a comprehensive approach to consumer financial protection that gives the CFPB jurisdiction over the entire industry, and diverse tools to wield to discharge its mission.

- CFPB has complaint handling and market monitoring powers, to learn about problems and compel responses from industry
- CFPB has supervision authority over
  - Large banks and credit unions,
  - Specific nonbank actors mentioned in statute
    - Mortgage lenders/servicers
    - Private education lenders
    - Payday lenders

- And can generally supervise “larger participants in other markets,” which has resulted in it implementing regulations to define and supervise larger participants in markets for:
  - Debt collection
  - Consumer reporting
  - Student loan servicing
  - Remittances
  - Auto financing
- CFPB has both general and specific rulemaking authorities
  - Implementing federal consumer financial laws, and
  - General UDAAP rulemaking authority
- CFPB also has statutory to focus on certain special populations (12 U.S.C. 5943 - Administration)
  - Office of Servicemember Affairs
  - Office for Older Americans
  - Private Education Loan Ombudsman; implied focus on Students and Young Americans)
  - Office of Fair Lending; mandates to protect people from “traditionally underserved” communities, including unbanked and underbanked consumers

Although the CFPB replaced some duties previously held by other agencies, such as rulemaking under existing consumer protection statutes, the CFPB also complemented the ongoing work of those agencies - and in some cases, helped make them better. I wholeheartedly agree with my co-panelists that it’s not duplicative per se to have concurrent authorities in some places in order to ensure that laws are properly enforced.

Under Director Cordray’s leadership, the agency discharged its mission not just by bringing cases and seeking monetary judgments, but also by conducting the research and supervision activities that helped other agencies do enforcement - demonstrating a <u>coordinated approach</u> that enabled the CFPB to be a “force multiplier” in our regulatory system.

<u>CFPB and predatory lending/Military Lending Act violations</u>

One example of the CFPB’s coordinative capacity, under original leadership: its supervision program included procedures for uncovering violations of the Military Lending Act, which caps interest rates at 36% APR for loans made to active duty servicemembers.

The Department of Defense (DOD) administers the MLA but consults with financial regulators when conducting rulemakings and ensuring compliance. Although DOD had the ability to consult with other agencies with supervision authorities prior to Dodd-Frank, it wasn’t until the

CFPB was up and running - with both supervision authority AND a mandate to protect consumers - that the conditions were ripe for smart enforcement.

Soon after taking on the responsibility to examine covered institutions for MLA compliance, the CFPB unearthed evidence that certain banks and nonbanks were trying to circumvent the law: for example, by offering high-cost "deposit advance" products structured as open-end lines of credit, or auto title loans with extended repayment periods, so they would fall just outside the scope of the regulations DOD had implemented at the time. The CFPB's findings, summarized in a 2014 report, led DOD to amend its regulations and clarify requirements for lenders to comply with the MLA.

CFPB and the student loan industry

The CFPB's ability to coordinate with other agencies has proven crucial in addressing the runaway student debt crisis. With no one agency previously responsible for the entire student loan industry, the CFPB's entrance onto the scene provided a much-needed focus on what happens to students when "financial aid" really equals debt for most people going to college today.

Although the Dept of Education administers the federal financial aid programs - by implementing standards for schools, determining student eligibility for aid, and creating loan repayment plans, it has never been set up to act as a financial regulator, or consumer protection agency. Furthermore, Dept of Ed does not oversee the private student lending market.

For these reasons, the CFPB's coordination with the Dept of Ed produced strong results. Through its supervisory activities and complaint handling activities, the CFPB issued many public reports detailing troubling findings of widespread problems, particularly for borrowers in repayment, and in 2012 issued a joint report with the Dept on private student loans that included policy recommendations.

The CFPB also uncovered evidence of predatory lending and debt collection schemes at the notorious for-profit chain Corinthian Colleges, and worked with the Dept of Education as it conducted its own probe into Corinthian's finances. By working together, the agencies developed an agreement to close Corinthian campuses and write off $480 million in private loans that students had incurred based on Corinthian's false promises, and which would have otherwise been difficult to discharge (because only federal loans come with a right to discharge if a school closes).

As these examples help illustrate, comprehensive and coordinated tools for enforcement can result in powerful wins for consumers. As we proceed to update and improve our state-level framework for consumer financial protection, these concepts will serve as useful guides.

Of course, it is important not just to think about comprehensive and coordinated tools for enforcement in abstract, but how they can be used to promote certain values. Recall again the specific populations that the CFPB is tasked to prioritize: servicemembers, students and seniors, as well as traditionally underserved communities. Here we find an important cue that is baked into the design of the CFPB, toward *equity*.

We need to imbue our state-level enforcers with the proper tools, and foster an orientation toward enforcement that ensures Californians can manage their financial lives without predation, discrimination, or uncertainty - with a cue toward equity, or put another way, "economic justice for all."

Thank you.

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Informational Hearing, The Consumer Financial Protection Bureau: An Examination of the CFPB under the current Federal Administration and Options for California to Better Protect its Consumers

Wednesday, March 27, 2019
1:00 PM

Written Testimony of Sharon Velasquez
Senior Economic Equity Program Manager
The Greenlining Institute

Thank you, Chair Limon, and members of the Committee for allowing me to speak today. My name is Sharon Velasquez and I serve as Senior Program Manager at The Greenlining Institute. Greenlining is a policy think tank advancing economic opportunity for people of color. We work to create wealth in communities of color to address the entrenched legacy of redlining: the racial wealth gap, which is the difference in wealth holdings across racial groups. Greenlining is a longtime supporter of the Consumer Financial Protection Bureau, and of its primary and statutorily vested purpose as a consumer protection agency.

As mentioned earlier, it is worthwhile to remember that the CFPB was originally created to protect consumers from fraudulent and abusive financial actors as a response to the 2008 financial crisis. Yet today under the Trump Administration, an agency founded as the people's bureau has in many ways become a bureau for the industry. One of the most concerning changes in the Bureau is a rollback in fair lending, which is a corruption of the CFPB's purpose.

The CFPB's traditional vigilance was critical for consumers of color because the agency was not race-blind in its oversight. It remained cognizant of the unfortunate 21st century reality that skin color still determines access to safe and sound financial products. Ample research shows that people of color continue facing racism in mortgage, auto, small business, and credit card lending markets. This can mean that people of color receive smaller amounts then requested, unfavorable terms, and higher rates of denials compared to their white counterparts.

Despite these realities, the CFPB's new leadership has taken the following actions, which threaten people of color's right to access fair and transparent financial products:

1. Questioned the theory of disparate impact and limited the use of disparate impact assessments. Disparate impact is a statistical analysis that looks for differences in how lending practices affect various communities when cases are brought under the Equal Credit Opportunity Act. It is a powerful enforcement tool that has been used in the vast majority of the CFPB's fair lending cases. Moreover, there has been an overall drop in enforcement actions, from 31 in Q3 2017 to 6 in Q3 2018.

2. Stripped its Office of Fair Lending and Equal Opportunity of enforcement powers and restructured it as a unit of internal advocacy. Under Dodd-Frank, the Office was tasked with "oversight and enforcement of federal laws intended to ensure the fair, equitable, and nondiscriminatory access to credit for both individuals and communities that are enforced by the bureau."

3. Seeking to expand fintech sandboxes – a testing ground for online financial products - that provide blanket immunity from state and federal consumer protection laws
    - Given the roll back of fair lending enforcement, this blanket immunity is all the more concerning because the FinTech industry services the underbanked, a majority of whom are people of color.

4. Suspending implementation of Section 1071 of Dodd-Frank. Section 1071 of requires the CFPB to implement small business data collection, and to make that data public. Notably, it requires the collection of race and gender of the small business owner to be collected. Currently, there is no comprehensive small business data collection at the state or federal level. The implementation of this rule is critical because it is well-known that small, women-owned, and minority-owned businesses struggle to access safe and sustainable credit

In conclusion, these actions will only exacerbate the racial wealth gap and bar people of color from fully and fairly participating in our economy. Clearly, consumer protection matters have been left to states.

It is heartening to see Chair Limon's leadership in exploring how the state can protect its consumers, and to see Governor Newsom prioritize high cost lending. With this leadership, California is poised to be a national leader in consumer protections.

Some solutions the state could explore, and that Chair Limon is already looking into:

- In terms of the DBO, envisioning what the next iteration of the agency can look like. The current DBO was created in 2013 with the merger of the Department of Corporations and the Department of Financial Institutions.

    - Better resourcing the DBO as our single in-state financial regulator with more enforcement attorneys to handle fair lending investigation. AB 1048 will address this.

    - Clarifying the DBO's mission as a consumer protector in the California Financial Code to make its consumer protection responsibility explicit

        - Expanding in-state small business data collection. Although we will not be able to collect state level race data due to ECOA, we can explore collecting other information such as zip code to determine lending in majority minority tracts and the quality of lending. In short, a conversation on this topic is timely.

        - The Silicon Valley is in our back yard and we need to be more proactive and less reactive to the changing face of finance:

            - FinTech algorithms and underwriting are opaque. We should provide adequate technology for DBO to audit algorithms to ensure they no longer raise fair lending and privacy concerns.
            - Explore what a regulatory framework for the FinTech industry could look like given the lack of comprehensive federal regulation

    - Aside from the DBO, taking a page from Maryland by creating a Financial Consumer Protection Commission, established to determine priorities and next steps as it responds to the CFPB's rollbacks. Membership on this commission could include legislators, the Attorney General, the DBO, Governor's Office, and advocates, among others.

    - Passing legislation requiring a racial impact analysis when considering banking related matters. For instance, under statute, Illinois is required to conduct this analysis if it considers raising check cashing fees in the future. There is interest in expanding this analysis to other policy areas.

    - Finally, California can pass a resolution in support of the Community Reinvestment Act, also known as the CRA. The CRA is under attack by the Trump Administration. The CRA is a civil rights law requiring banks to serve low- and moderate-income communities, and those traditionally excluded from our financial system, and to reinvest in those communities. These private dollars help finance affordable housing, small business loans, mortgages, broadband, and more. In doing so, California would be the first state in the nation to pass such a resolution supporting equitable access to banking for all Californians, regardless of race and income, and to underscore how CRA must be strengthened and not weakened.

There are a lot of opportunities to do good by Californians. Thank you, Chair Limon, for seizing the moment.

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Informational Hearing of the Assembly Committee on Banking and Finance and Select Committee on Technological Advances

Virtual Currency Businesses: The Market and Regulatory Issues

Thursday, October 17, 2019, 10:00am

Rio Hondo Community College, Whittier, CA

Agenda

1) Welcome and Opening Remarks
   a) **Assembly Member Monique Limón,** Chair, Assembly Banking and Finance Committee
   b) **Assembly Member Ian Calderon,** Chair, Select Committee on Technological Advances
2) The Business Perspective
   a) **Ally Medina,** Executive Director, Blockchain Advocacy Coalition
   b) **Brian Brooks,** Chief Legal Officer, Coinbase
   c) **Stuart Alderoty,** General Counsel, Ripple
3) The Consumer Perspective
   a) **Rainey Reitman,** Chief Program Officer, Electronic Frontier Foundation
   b) **Suzanne Martindale,** Senior Policy Counsel & Western States Legislative Manager, Consumer Reports
4) The Regulatory Perspective
   a) **Manny Alvarez,** Commissioner, Department of Business Oversight
   b) **Keith Rowley,** Uniform Law Commissioner
5) Public Comment

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Joint Informational Hearing
Assembly Banking and Finance Committee
Assembly Select Committee on Technological Advances

Virtual Currency Businesses: The Market and Regulatory Issues
Thursday, October 17, 2019
10 am, Rio Hondo Community College, Whittier, CA

1. **Hearing Goal.** The goal of this hearing is to provide information to members of the Legislature about (1) the emerging industry of businesses that facilitate the exchange, transfer, and storage of virtual currencies and (2) regulatory issues related to the industry. Since the introduction of Bitcoin in 2009, computer programmers have developed thousands of different virtual currencies, and hundreds of businesses have sprouted up to provide services to virtual currency users. Although some virtual currency business activity is subject to a combination of existing state and federal laws, a lack of regulatory clarity and adequate protections for users of virtual currencies may negatively affect businesses, consumers, and investors in California.

   Topics that will be discussed during the hearing include:
   - An overview of the virtual currency industry and how existing laws impact companies in the industry,
   - Potential risks to consumers or investors due to negligent, fraudulent, or unscrupulous actions by virtual currency businesses,
   - Guidance from the Commissioner of Business Oversight related to the pros and cons of establishing a new regulatory framework specific to virtual currency business activity and issues the Legislature may consider when designing such a framework,
   - A summary of the model regulatory framework adopted by the Uniform Law Commission (ULC) and discussion of the process for how the ULC reached their conclusions.

   The Committees will hear from industry representatives, consumer organizations, state regulatory officials, and policymakers associated with the ULC.

2. **What is virtual currency?** A virtual currency is a digital representation of value that is not issued or backed by a government or central bank. Virtual currencies are a form of electronic money and serve one or more of the traditional functions of money: a medium of exchange, a unit of account, and a store of value. Unlike the US dollar, virtual currencies are not considered legal tender[1], but private parties may agree to use a virtual currency to facilitate an economic exchange.

   Virtual currencies are created by either a centralized issuer, a decentralized protocol, or a hybridization of the two models. Under centralized issuance, a single entity has the ability to

[1] A legal tender is a medium of exchange that is legally approved as a mechanism to repay a debt.

create units of the virtual currency and serves as the record keeper for transfers of the virtual currency between parties. In the centralized issuance model, users of a virtual currency must trust the issuer to manage the creation and record keeping processes in a manner that supports the currency's effectiveness as a medium of exchange and store of value.

Bitcoin and many other virtual currencies are created and tracked via a decentralized protocol, rather than the centralized issuance model that prevails in the world of fiat money.[2] The most commonly used technology that underpins decentralized virtual currencies is distributed ledger technology, or DLT. DLT is essentially a decentralized database that is managed by multiple parties within a network. When a new transaction occurs, whether the creation of a new unit of virtual currency or the transfer of an existing unit of virtual currency between parties, DLT notifies all members of the network about the new transaction by updating the ledger. Blockchain is the most well-known type of DLT and is the technology that underpins Bitcoin.

In the decentralized model, users do not need to trust a single entity to manage the virtual currency. Instead, DLTs rely on consensus algorithms that are designed so that network participants must arrive at an agreement when adding new transactions to a ledger. The ledger is visible to all parties in the network and is secured by sophisticated cryptography,[3] which ensures that a unit of virtual currency cannot be simultaneously used by multiple parties.

The Bitcoin source code was released by a pseudonymous individual or group in 2009, and Bitcoin is regarded as the first successful decentralized virtual currency. The blockchain technology that underpins Bitcoin is designed to address longstanding problems in computer science related to consensus protocols and double-spending of a digital asset or currency. While Bitcoin is the most popular virtual currency, there are more than 2,000 virtual currencies currently available on trading platforms.[4] Many of these *altcoins*, or alternatives to Bitcoin, rely on adaptations of the technological breakthroughs contained in the Bitcoin source code

3. **How do businesses participate in virtual currency markets?** Developed markets for virtual currencies typically rely on businesses that serve as intermediaries between users. In theory, decentralized virtual currencies, like Bitcoin, do not require intermediaries to exchange, transfer, or store units of virtual currencies. In practice, however, transactions between users can be facilitated more safely and more conveniently by using trusted intermediaries, similar to how the banking system evolved to provide intermediary services in the fiat-denominated economy.

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[2] Fiat money is often used interchangeably with legal tender. Fiat money is currency that has been established as money by government decree or law. The US dollar, euro, and Mexican peso are examples of fiat money.
[3] Cryptography refers to techniques for securing communications through the use of codes.
[4] https://coinmarketcap.com/all/views/all/

Businesses that serve virtual currency users provide a combination of services that fall in three general categories: transfer, exchange, and storage.[5]

- Transfer refers to an activity where a business takes funds or value from one end of a transaction and delivers those funds or value to a designated person on the other end.
- Exchange refers to transferring an amount of virtual currency in exchange for an agreed upon amount of fiat currency, or vice versa. Exchange also includes transferring one type of virtual currency for a different type of virtual currency at an agreed upon rate.
- Storage refers to receiving and safekeeping virtual currency on behalf of someone else. Storage is analogous to a bank accepting funds on deposit. Virtual currency storage is often facilitated by the use of a digital wallet that makes transferring or exchanging virtual currency more convenient for users.

4. **What is the current regulatory landscape for virtual currency businesses?** Virtual currency business activity is relatively new, and it is often unclear how existing state and federal laws apply to such activity. Many virtual currencies have a combination of properties that straddle multiple regulatory areas, including laws that govern securities, commodities, and money transmission, which further complicates the application of laws to virtual currency business activities.

   A lack of regulatory clarity can harm businesses and users. Businesses may invest resources in developing services that ultimately could be deemed unlawful by state or federal regulators. Users may have trouble identifying legitimate businesses from illegitimate ones without a state or federal licensing authority's stamp of approval.

   Policymakers may also be concerned about important policy objectives that can be undermined by unregulated virtual currency business activity. Virtual currencies allow users to transfer large amounts of value over long distances while masking the identities of both the sender and receiver, which raises significant concerns about money laundering, tax evasion, and terrorist financing.

   Currently, there is neither a comprehensive regulatory approach from the federal government, nor a widely adopted approach at the state level. Instead, a patchwork of existing laws are applied, not always uniformly, by various federal and state regulators based on factors including the technological design of a virtual currency and the way a virtual currency is used.

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[5] Businesses may offer additional services related to virtual currencies that do not fall neatly under any of these three categories, such as derivate trading products.

Federal

Existing federal law provides both the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) with partial jurisdiction over virtual currency businesses.

SEC jurisdiction applies when a unit of virtual currency is considered a security. The legal standard that defines a security is a four-pronged test: there must be (1) an investment of money, (2) in a common enterprise, (3) with the expectation of profit, (4) from the managerial efforts of others. When deemed a security, the SEC authority is most often related to Initial Coin Offerings (ICOs) and trading activities, which subjects a virtual currency business to requirements related to registration, cybersecurity, and implementing policies to prevent fraud and market manipulation.

CFTC jurisdiction applies when a virtual currency product is a derivative of a commodity. Units of virtual currency that are deemed not to be securities may be subject to commodities law. For example, Bitcoin does not meet the definitional requirements of a security, but it is considered a commodity by the CFTC. Exchanges involving fiat currency to Bitcoin are not under CFTC jurisdiction, but a derivative product based on Bitcoin, such as a futures contract that states a ratio in US dollar to bitcoin, is subject to CFTC enforcement.

Congressional interest in virtual currencies increased in 2019 upon Facebook's announcement that it intends to develop a virtual currency named Libra in conjunction with major companies in the financial services industry. Both the House Financial Services and Senate Banking Committees held hearings about Facebook's plan in July 2019. During those hearings, both Republican and Democratic legislators voiced concerns due to Facebook's failures in protecting consumer data. Facebook's announcement has led some Members of Congress to introduce legislation to bar large technology companies from providing financial services.[6] A comprehensive approach from Congress related to virtual currency business regulation, however, does not appear to be imminent.

States

There is not a uniform approach to the regulation of virtual currency businesses at the state level. All states, except Montana, have laws that regulate money transmitters, but such laws vary between states and state regulators differ in their interpretations of whether and in which cases state money transmission laws apply to virtual currency businesses. The following examples shed light on the range of state actions in this space.

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[6] https://www.cnn.com/2019/07/15/tech/facebook-libra-ban-draft/index.html

- *New York:* New York attempted a comprehensive approach to regulating virtual currency businesses with the introduction of BitLicense in 2014. The state financial regulator, New York State Department of Financial Services (DFS), issued a regulation that requires companies to have a license prior to engaging in specified activities, including virtual currency transmission, storing virtual currency on behalf of others, issuing a virtual currency, and performing exchange services. To obtain a license, companies must pay a $5,000 application fee, maintain sufficient capital as determined by DFS, and have an anti-money laundering program and cybersecurity program, along with a list of other requirements common in the financial services industry. Due to these requirements, some virtual currency companies have decided to exit the state and deny service to New York customers.[7] Twenty-one companies have received a BitLicense since its inception.
- *California:* The state's Money Transmitter Act (MTA) does not expressly address virtual currencies or virtual currency business activity. The Department of Business Oversight, who enforces the MTA, has not released comprehensive official guidance on the applicability of the MTA or other state laws on virtual currency business activity. Rather, DBO responds to specific requests from companies on a case-by-case basis and posts a redacted version of its response letters on its website.
- *Wyoming:* Wyoming has emerged as the most business-friendly state for virtual currency businesses. The Legislature passed and the Governor signed an express exemption for virtual currencies from the state's Money Transmitter Act in 2018. The state also exempted certain virtual currency tokens from state securities laws, but the impact of such an exemption is muted by federal laws that may take precedence.

5. **What risks to consumers and users of virtual currencies exist in the market today?**
Adoption of virtual currencies by American consumers is low, with industry-sponsored surveys indicating that 5-10% of respondents own a virtual currency.[8][9] Research indicates that only 1% of virtual currency transactions involve a merchant,[10] which means that virtual currencies are rarely used as a form of payment for goods or services. The same study showed that nearly 90% of transactions involved an exchange, indicating that the predominant motivation for users to purchase a virtual currency is speculation that it will increase in value relative to other assets.

Although virtual currencies may be seldom used for purposes beyond speculation, policymakers have an interest in protecting users from fraudulent and criminal activities. In 2014 the federal Consumer Financial Protection Bureau (CFPB) issued a consumer advisory that cautioned consumers about risks posed by virtual currency.[11] The CFPB warned against hackers and fraudulent schemes, as well as price volatility and transaction costs compared to traditional

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[7] https://www.coindesk.com/bitlicense-refugees-kraken-shapeshift-ceos-talk-escape-new-york
[8] https://www.bitcoinmarketjournal.com/how-many-people-use-bitcoin/
[9] https://cointelegraph.com/news/11-of-americans-own-bitcoin-major-awareness-increased-since-2017
[10] https://www.latimes.com/business/la-fi-bitcoin-rally-blockchain-speculation-20190531-story.html
[11] https://files.consumerfinance.gov/f/201408_cfpb_consumer-advisory_virtual-currencies.pdf

payment methods. The CFPB also warned consumers that virtual currency businesses do not provide the level of protections that consumers expect from banks and credit unions.

Examples of large hacks or fraudulent schemes include:

- Mt. Gox, $487 million – Mt. Gox was a Tokyo-based exchange platform that was the world's largest Bitcoin exchange prior to its failure in 2014. Hackers infiltrated the company's network in 2011 and began skimming bitcoin from electronic wallets. When the security breach and theft was announced in 2014, hackers had stolen 850,000 bitcoin, which was valued at $460 million at the time, and about $27 million in cash held by the company. Mt. Gox filed for bankruptcy and liquidated in 2014. A portion of the stolen funds were recovered, and the legal process of partially refunding users is still ongoing.
- Coincheck, $530 million – Coincheck is a Tokyo-based exchange platform. In January 2018 the company was hacked and lost $530 million worth of users' virtual currencies. The company initially stated that it did not have funds to cover the losses, but later committed to refunding users. Japan's financial regulator was involved in assessing the company's capacity to issue the refunds.
- Bitfinex, $72 million – Bitfinex is a Hong Kong-based exchange platform. In August 2016 the company announced that nearly 120,000 bitcoin were drained from user accounts by hackers, reflecting a value of $72 million at the time.
- iFan and Pincoin, $660 million – A Vietnam-based company called Modern Tech was allegedly behind two fraudulent Initial Coin Offerings (ICOs) for start-ups iFan and Pincoin. ICOs are a way for tech startups to raise capital from investors, similar to the Initial Public Offering, or IPO, that makes a company's stock publicly available for purchase. Modern Tech allegedly packed up its offices in Ho Chi Minh City and disappeared in 2018 after raising $660 million from investors.

6. **What is the Uniform Law Commission and how do they propose regulating virtual currency business activity?** The Uniform Law Commission (ULC) has worked for the uniformity of state laws since 1892. It is a non-profit unincorporated association, comprised of state commissioners on uniform laws from each state, the District of Columbia, the Commonwealth of Puerto Rico, and the U.S. Virgin Islands. There is only one fundamental requirement for the more than 300 uniform law commissioners: that they be members of the bar. The state uniform law commissioners come together as the ULC for one purpose—to study and review the law of the states to determine which areas of law should be uniform. The commissioners promote the principle of uniformity by drafting and proposing specific statutes in areas of the law where uniformity between the states is desirable.

   In July 2017 the ULC adopted the Uniform Regulation of Virtual-Currency Businesses Act after an extensive stakeholder process and multiple rounds of drafting, review, and amendments. The act defines several key terms that govern whether a company's activities would be subject to regulation, including definitions of virtual currency, virtual currency business activity, control, exchange, store, and transfer. The act proposes a licensing framework for companies with virtual

currency businesses activity greater than $35,000 annually, with specified exceptions. The licensing framework establishes criteria for approval of a license application, provides examination and enforcement authority to a state regulatory agency, mandates disclosures and other protections for users, and mandates compliance programs and policies.

The ULC framework has been introduced in five state legislatures, but no state has adopted it yet.

7. **Additional Resources.**

Massad, Timothy G., Brookings Institute, *It's Time to Strengthen the Regulation of Crypto-Assets.* March 2019. https://www.brookings.edu/wp-content/uploads/2019/03/Economis-Studies-Timothy-Massad-Cryptocurrency-Paper.pdf

Van Valkenburgh, Peter, Coin Center. *The Need for a Federal Alternative to State Money Transmission Licensing.* January 2018. https://coincenter.org/files/2018-01/federalalternativev1-1.pdf

Van Valkenburgh, Peter, and Jerry Brito. Coin Center. *State Digital Currency Principles and Framework.* March 2017. https://coincenter.org/files/2017-03/statevirtualcurrencyprinciplesandframeworkv2.0.pdf

Virtual Currency Hearing Testimony

I'm Alexandra Medina, Director of the Blockchain Advocacy Coalition. The BAC was formed over a year ago after a group of mid size blockchain and virtual currency companies in the state realized that there was no organized effort to engage with policymakers in the 5th largest economy in the world on behalf of the blockchain community. Last year we supported the passage of SB 838 and AB 2658 as small but meaningful steps towards acknowledging the impact of the blockchain industry in CA and starting to develop policy around that.

I've provided a FAQ sheet about CA's blockchain industry. It's by no means exhaustive, but it's a high level view of what the industry looks like both here and abroad. We currently have 734 blockchain companies in this state. That's a number that surprised me because last year in August we had only 315. That sounds like healthy industry growth until you compare it globally. The number of blockchain businesses globally increased from 2017 to 7370 in the same time frame. We've actually lost ground in the state. Last year the US had 27.2% of the global market share and CA accounted for 11.7% of that. Currently the US has 25.9% and CA just under 10%. If you look at the chart I've provided this is a continuation of a trend, we've lost marketshare since 2012. We have a significantly smaller marketshare in CA than in any other technology industry I looked at. Most hover around 20% and we are down to half that. The point I'm trying to hammer here is that CA has a much smaller amount of the blockchain industry than we should being the home of Silicon Valley and Silicon Beach. And more concerningly, we are consistently losing that industry.

Most of you are familiar with the concept of Bitcoin and probably Facebook's Libra and perhaps even the businesses the other panelists up here represent. But here are some other examples of how this technology is used in California: Propy streamlines real estate transactions on blockchain, Civic is creating secure identity platforms, IBM and Sweetsense teamed up to create a platform for farmers in areas with overdrafted aquifers to trade water.

The vast majority of blockchain businesses in this state are not extremely large and well funded. Nearly ⅔ of them have 10 or fewer employees. Only 47 of the 734 have more than 50 employees. These companies have a median funding amount of 2.5 million, according to Crunchbase. The average company has a median funding amount of 4.5 million. So why are we losing blockchain companies as a nation and a state? Pretty simple- it's the regulatory uncertainty.

A Morgan Stanley report indicated the greatest predictor of where a business chooses to locate is regulatory clarity. We do not have clarity here. There are 4 definitions of cryptocurrency at a federal level. SEC sees some as securities, the CFTC has claimed commodities, the treasury considers them a currency and the IRS taxes them as...a property. In addition to obtaining necessary federal MSB licenses companies that wish to engage all US customers must seek comply with individual licensing requirements in all 50 states.

To obtain licenses at a federal level and then in every state requires an inordinate amount of a start ups resources. And some of those individual state requirements are extremely onerous. The most infamous one being New Yorks' 2015 BitLicense. In the first 3 years the New York issued a mere 5 licenses. They make the DMV look expeditious. Headlines sprung up about the "Great Bitcoin Exodus". Many companies left New York rather than devote resources to languishing in a regulatory bottleneck. Washington state many businesses left after the passage of SB 5031 in 2017. The key issues cited were bond and data collection requirements.

When blockchain businesses leave our state or country they mostly go to a handful of other countries. Singapore is a popular destination for california companies to register in. The Singaporean government is working to attract blockchain companies and investment. Their taxation agency is proposing to remove the 7% goods and services tax from cryptocurrency transactions that function or are aimed to function as a medium of exchange. They issued a set of guidelines last November that clarified regulations that pertain specifically to digital assets representing securities or derivatives contracts.

Switzerland similarly differentiates between types of tokens, creating 3 categories: payment, utility, and asset tokens. They have attracted many companies with this framework and recently awarded the first banking license to a crypto company. Neither country has lax standards and both still have strict kyc/aml requirements, but the clarity of the regulatory framework is attractive for businesses.

In April of this year Texas released guidance for virtual currency companies stating that cryptocurrencies as currently implemented cannot be considered money or monetary value under their Money Services Act. It goes on to clarify which sorts of business might be considered a money transmitter. For example: Exchange of cryptocurrency for sovereign currency through a third-party exchanger is generally money transmission but clarifies that bitcoin atms that facilitate a sale or purchase of Bitcoins by the machine's operator directly with the customer would be exempt.

Colorado, Montana and Wyoming- a state that's really trying to get a crypto market going- have all defined consumptive or utility tokens as exempt from state securities law. This is a step toward the structures Singapore and Switzerland have enacted.

I applaud Asm. Calderon's commitment to understanding and engaging on blockchain issues in the legislature. The language he has proposed in AB 1489 came from the Uniform Law Commission's Supplemental Act. However, the same language has faced roadblocks in Nevada, Hawaii and Oklahoma.

The goal of creating a streamlined, reciprocal licensing system across states is admirable. Reducing the amount of individual states that a company needs to apply for would reduce costs and encourage mid-size companies to stay in the US. Even if it did pass in all 4 states it would do little good to the industry here and as currently written and could accelerate the loss of the blockchain businesses.

Here are some issues I'd ask the committees to consider when discussing virtual currency regulation:

1. If a company already has a lenders license or MTL in this state would they also have to apply for this even if their license covers the scope of their business? That should be clarified to remove redundancy.
2. Should the state consider defining digital assets based on their function and regulate them separately as other states and countries have done?
3. Are wallet to wallet transactions or bitcoin atm transactions as detailed in the Texas guidance captured unintentionally under this framework?
4. Are the surety bond and personal wealth requirements prohibitive to small businesses? I know there is the 35k exemption but that's just extremely low for a state like California. I do not know who would even take advantage of that.
5. Are the data requirements tailored to increase consumer protection rather than create a potential security risk?

TESTIMONY OF BRIAN P. BROOKS
CHIEF LEGAL OFFICER, COINBASE GLOBAL, INC.
BEFORE THE ASSEMBLY JOINT HEARING, BANKING AND FINANCE AND SELECT COMMITTEE ON TECHNOLOGICAL ADVANCES

October 17, 2019

Leader Calderon, Chair Limon, and Committee Members:

My name is Brian Brooks and since September 2018 I have served as Chief Legal Officer of Coinbase Global, Inc. I am pleased to have the opportunity to appear before you to discuss the structure of the virtual currency market, the regulatory structure currently in place to protect investors and consumers from potential risks, and our views on the Uniform Law Commission's work in this area.

Coinbase Background

Before addressing the Committee's specific areas of interest, please permit me to address the perspective Coinbase brings to the discussion. Among other businesses, Coinbase, which is headquartered in San Francisco, is the largest virtual currency trading platform in the United States. We have more than 30 million accounts for more than 14 million distinct customers who collectively have traded more than $150 billion in cryptoassets. Our investors include not only well-known Silicon Valley names such as Andreesen Horowitz and DFJ, but also traditional banks and securities firms such as the New York Stock Exchange and the Japanese bank MUFG. Coinbase has more than 800 employees, the majority of them based in California and the remainder based in offices in Portland, Chicago, New York, London, Dublin, and Tokyo.

While we are best known as a platform for buying and selling virtual currencies, we are also the largest custodian of cryptoassets in the world, with over $20 billion in assets under custody. Our stablecoin, which is built on blockchain technology but whose value is backed 100 percent by U.S. dollar balances held in FDIC-insured bank deposit accounts, is one of the 25 most widely traded virtual currencies in the world, with almost $475 million in circulating supply and daily transaction volume of over $150 million. We have pioneered a number of innovations designed to make it easier for everyday customers to access, use, and earn returns on virtual currency holdings, including paying rewards on our stablecoin balances, creating a "staking" platform that allows our customers to earn a rate of return on their proof-of-stake tokens, and other products that make cryptocurrency safer, more valuable, and easier to use.

Market Structure

The market structure of the cryptocurrency market is relatively straightforward.

The manufacturers of the product in this market are referred to as ***project developers*** or ***asset issuers***. At present there are more than 2,000 cryptocurrencies in circulation globally. These tokens represent projects in a wide range of areas, ranging from tokens used to make purchases inside of video games to tokens used to power polling and prediction markets to tokens used in payments systems and lending platforms. It is important to remember that the core purpose of cryptocurrency is not investment returns or even necessarily financial transactions; the core purpose of cryptocurrency is to enable ledgers to be maintained for various purposes without the need for banks or other intermediaries that historically imposed costs and other frictions on the system. Some assets are referred to ***security tokens*** and are registered with the Securities and Exchange Commission like any securities, while others are not regulated as securities.

Asset issuers generally distribute cryptoassets either through ***airdrops*** (distributions of assets for free to large numbers of wallet addresses); ***initial coin offerings*** (often through a Simple Agreement for Future Tokens ("SAFT")), though these have become less common due to their potential for securities law compliance issues; ***initial exchange offerings***; or ***Regulation D or other exempt offerings*** under the securities laws.

Following the initial distribution of a particular cryptoasset, secondary trading occurs on ***crypto exchanges*** like Coinbase. Crypto exchanges maintain order books that match buy/sell orders for various asset pairs. Order books that match different pairs of crypto assets are referred to as ***crypto-to-crypto*** trades, while order books that allow exchanges of crypto assets and fiat currencies are referred to as ***fiat-to-crypto*** trades. Some crypto exchanges make ***margin loans*** to allow the purchase of limited amounts of cryptoassets subject to the exchanges' credit policies.

Participants in cryptocurrency transactions including both ***retail and institutional investors*** as well as users of cryptoassets for specific use cases. Coinbase alone has more than 14 million retail investors on its platform. In addition, institutional investment in crypto has been on the rise over the past several years and now includes Ivy League and other major university endowments, hedge funds and asset managers, mutual funds, and other significant institutions. Once an investor buys a particular token, the investor can hold it; can sell it on an exchange; can send it to another person on the original exchange or to a recipient on a different exchange; or can send it to a ***private or user-controlled wallet*** that is not associated with an exchange.

These investors and users must safeguard their ***private keys*** which allow them to access the cryptographic codes that represent their individual cryptoassets. These private keys can be custodied either in a ***hosted wallet*** typically maintained by a ***custodian*** which may also be an exchange (Coinbase is the largest custodian of cryptoassets in the world, as noted above), or in a ***user-controlled wallet***. To provide custody to SEC-registered investment advisers, a custodian must meet the requirements of the SEC's ***qualified custodian rule***.

Regulatory Structure

Contrary to popular belief, the cryptocurrency market is subject to a complex web of state and federal regulatory oversight.

At the federal level, investor protection oversight is provided by the Securities and Exchange Commission and the Commodity Futures Trading Commission. The SEC polices both compliance with the Securities Act of 1933, which imposes disclosure and other requirements on assets that qualify as "securities" under federal law, and the Securities Exchange Act of 1934, which imposes requirements on national securities exchanges and alternative trading systems. In addition, the SEC promulgates regulations that govern crypto custodians under the Investment Advisers Act. The SEC has used its authority to issue extensive guidance to asset issuers and crypto exchanges, and has brought a number of high-profile enforcement actions against asset issuers.

One key regulatory gap has been a lack of clarity concerning which specific tokens constitute securities under the Securities Act and related SEC guidance. To address this gap and operationalize case law and SEC guidance, Coinbase and seven other exchanges, investors, and custodians formed the Crypto Rating Council to assess the likelihood that any given token could be deemed to be a security under existing law. The founding members expect that the Crypto Rating Council will aid the SEC in allocating enforcement resources to those assets most likely to qualify as securities and away from other assets, and will also aid investors in understanding the legally safe areas of crypto.

The CFTC, in turn, regulates spot markets, margin lending, and derivatives, among other things. Like the SEC, the CFTC has issued extensive guidance on major crypto regulatory issues, and has also approved various innovative crypto products such as crypto futures markets.

Other federal regulators are also playing an active role in crypto markets. The Federal Trade Commission has brought enforcement actions under the consumer protection laws. The Treasury Department's Financial Crimes Enforcement Network has brought money-laundering and other actions against bad actors in the crypto sector.

At the state level, most states, including California, regulate certain cryptocurrency activities as money transmission activity requiring a money transmitter license. Some states impose separate licensure requirements on crypto exchanges that offer margin loans to their customers. A few states, most notably New York but also a few others, have crypto-specific legislation that licenses cryptocurrency trading activity separately from other money transmission activity. And a similarly small number of states have specific trust company laws that allow trust companies to serve as custodians of cryptoassets.

The theme that should emerge from this recitation is that crypto activity is far from un- or under-regulated; on the contrary, regulation of crypto activity is arguably more complicated than it needs to be, with overlapping and sometimes inconsistent regulation from state to state, the need to obtain multiple licenses to conduct crypto activity even within a single state, and a bizarre lack of reciprocity among the various states. What is needed is clarity and simplicity.

Coinbase believes that, in this complexity, there is an opportunity for California to lead. The opportunity is not in passing yet more layers of license requirements, but in creating a single charter for crypto companies that would allow such companies to operate within a single corporate entity that is supervised in a rigorous manner but without the ambiguity and complexity that characterizes the status quo. California could successfully compete with New York for crypto businesses if it solved a few discrete problems.

First, California could offer a single charter that simultaneously authorized the holder to trade, lend, and custody crypto assets. Currently, these activities require three different licenses in both California and New York.

Second, California could provide business-plan approval for its charter holders, allowing them, for example, to trade all crypto tokens, or all crypto tokens that do not constitute securities under federal law, or all tokens within other specified categories. Currently, New York's BitLicense requires licensees to seek individual approval for each new asset they propose to list -- meaning that the BitLicense itself is not sufficient conduct any crypto business until that individual business is approved separate from approval of the BitLicense itself.

Third, California could include lending powers in its crypto charter. Currently, to lend for margin purposes or other purposes, a company requires a separate consumer or commercial lending license. Since the supervisor of those licenses is the same as the supervisor for money transmission licenses, it makes little sense to require a separate license for each activityl

Fourth, California could authorize custody activities to be conducted inside of a single crypto charter instead of requiring a separate trust company license to conduct such activities. Again, since the same agency regulates both money transmission and custody, it makes little sense to require separate licensure for the two activities. Like New York has already done, California should specify that crypto custody is a fiduciary activity. That designation is important for purposes of complying with the SEC's qualified custodian rule.

We believe the power to consolidate all these authorities within one single, rigorously supervised charter is within the Department of Business Oversight's existing authority, and we thank Commissioner Alvarez for engaging with the industry on these ideas since he took office.

<u>The Uniform Law Commission's Model Virtual Currency Business Act</u>

Coinbase has appreciated the opportunity to comment on earlier drafts of the Uniform Law Commission's work. Some of our comments have been reflected in revisions to the most recent version. Among our most important concerns have been:

- As noted above, there is already significant state and federal licensure and regulation in this area. At a minimum, the Model Act needs to exempt companies currently operating under money transmitter licenses so as to avoid literally duplicative regulation of the same activity.
- The Model Act should allow licensees to maintain the value of customer crypto assets ***in like crypto holdings***, without requiring that they be collateralized in fiat currency.
- The Model Act should regulate crypto activity separate and apart from UCC Article 8, since most crypto assets are not securities for any other purpose and application of a long-established commercial rule set designed for investment securities to non-securities could have unintended and unanticipated consequences both in the crypto market and in the securities market.

As noted above, we believe a better focus for California would be to adopt a clearer and more streamlined regulatory regime -- focused on a single charter for crypto activities that allows trading, lending, and custody to occur inside of a single charter -- that would position California favorably to compete with New York to be the hub of the crypto ecosystem. This is appropriate since much of the technology and many of the companies involved in this area were built here.

Thank for the opportunity to speak with you today. I look forward to answering your questions.

TESTIMONY OF STUART ALDEROTY
General Counsel of Ripple Labs, Inc.
California State Assembly Committee on Banking & Finance and
Select Committee on Technological Advances
October 17, 2019

Chair Limón, Chair Calderon, and distinguished members of the Committee and Select Committee, thank you for the opportunity to appear before you today.

I am Stuart Alderoty and I am the General Counsel of Ripple.

Ripple is an enterprise blockchain company headquartered in San Francisco with actual products in commercial use. We are working with - not against - regulators, governments, and central banks throughout the world, to improve the way the world moves money. Ripple's global payments network includes over 200 customers across 40+ countries and six continents.

I joined Ripple in January after over three decades of practicing law in New York where I was a partner with a global law firm and where I held senior leadership positions - including General Counsel roles - with public financial institutions such as American Express, HSBC, and CIT Group.

It is our firm belief that having a clear regulatory approach to digital assets is important for innovation if this space is to flourish. Bringing industry participants, consumer advocates, and regulators together, as you have done today, is precisely what is needed to reach such an outcome. To that end, we believe there is no better place for this conversation to take place than here in California.

As the birthplace of Silicon Valley - and thus, many of the start-ups that lie at the heart of Americans' everyday lives, including Google, Apple, and Amazon - California understands well the promise (and challenges) that new technology can hold. The state's recently established Blockchain Working Group is but one example of how California is choosing to take a leadership role. Ripple is proud that its own Vice President of Global Tax and Chief Tax Counsel will serve as a member of that Working Group.

And leadership is so very necessary given the potential transformative impact that advances in these technologies - particularly in the payments space - can have, not only for citizens of California but worldwide. First, today's global payments system is slow, often taking days to complete. Indeed, the quickest way for me to send money cross-border is literally to place it in a suitcase, drive to the LA airport, and physically take it with me to the destination. Second, the process is expensive - on average globally, currency conversions and fees equal approximately 7 percent of the total sent. Finally, cross-border transactions are frequently fraught with execution risk and offer little communication or visibility to either the sender or recipient of funds.

Blockchain technology and digital assets promise to change this by enabling faster, cheaper, and more transparent payment systems. RippleNet was specifically developed to provide instant settlement and complete transparency in cross-border transactions. RippleNet's On-Demand Liquidity solution uses the virtual currency, XRP, as a bridge to facilitate fiat to fiat currency transactions and deliver these benefits at scale. We partner with banks and financial institutions, including payment providers, to remedy the fundamental shortcomings of cross-border payments by enabling interoperability between networks.

Importantly, these advances do not require us to displace fiat currency or compete with the central banking system. Rather, as mentioned, Ripple works with regulators, governments, and central banks globally to improve the way the world moves money.

What does this mean for California specifically? It is currently estimated that approximately 800 million people globally (or one in nine) are the recipients of funds sent home by migrant workers. As many of you are personally aware, California is home to multiple counties where migrant workers - who are employed in many industries ranging from agriculture to technology - comprise more than a third of your constituents, including Santa Clara, San Francisco, and San Mateo. Ripple's solutions are specifically designed so that banks, financial institutions and payment providers can help immigrants send money home cheaply and efficiently, where it can then be used to cover living essentials. Even where remittances represent a small portion of what migrants earn, these funds often represent "a lifeline" for millions of families worldwide.

To date, neither Congress nor U.S. regulatory agencies have established a clear regulatory framework for digital assets. This space is thus ripe for leading states, like California, to set out a workable policy that would provide an example for other lawmakers and regulators to follow. Any framework should start with a clear token taxonomy - meaning a clear and simple categorization of tokens defining whether a token is, for example, a security token (does the token represent a share of a company), or a utility token (does the token represent access to a particular service or reward), or a payments token that helps bridge payments and remittances, or perhaps a simple store of value like digital gold.

With that clear token taxonomy as a foundation, the industry, the public, and the regulators would then know which digital assets fall inside which "regulatory perimeter" - meaning, which existing laws apply to which token asset class. For example, which tokens are regulated under security laws and which under money transmitter laws, and how do privacy regulations and consumer protection laws apply? Any taxonomy should also retain some flexibility in recognition of the fact that digital assets can (and do) move between classifications over time as the technology and use cases evolve.

Taking steps along these lines - as the U.K., Switzerland, and Singapore all have recently done - will not only foster innovation and protect consumers, but allow California to continue to recruit new companies and promote emerging technologies that bolster its status as a world-class

destination for innovation, and the jobs and tax revenues such innovation creates. If not, there is a real risk, that we are already seeing, that this technology will simply move offshore.

California has already started the process of trying to provide direction through the introduction of AB 1489. We believe that further study of this legislation (and any amendments to it) will be helpful in moving the discussion forward in a productive way.

We believe these innovations are here to stay. To us, this is a timely and important dialogue and we appreciate the opportunity to take part in it with you.

Thank you.

Assembly California Legislature

Assembly Committee on Banking and Finance

Informational Hearing of the Assembly Committee on Banking and Finance and Select Committee on Technological Advances

Virtual Currency Businesses: The Market and Regulatory Issues

Testimony of Rainey Reitman
Chief Program Officer
Electronic Frontier Foundation

October 17, 2019

Thank you for the opportunity to testify about the potential regulation of blockchain technologies in the state of California. I represent the Electronic Frontier Foundation, a non-profit civil liberties law and technology organization. Founded in 1990, EFF champions privacy, free expression, and innovation. We have over 30,000 dues-paying members. The majority of EFF's funding comes from these individual people, and that is because our mandate is to represent the concerns of technology users, both today's technology users and tomorrow's.

I am the Chief Program Officer of EFF, and I have written and spoken publicly about the civil liberties implications of blockchain technology and its potential regulation since 2011.

I am honored to speak with you about this issue today. As the California legislature considers potential regulation of blockchain, I would like to offer a few thoughts to help frame the conversation.

First, policymakers should note that the impetus behind blockchain technologies is one that seeks to empower consumers in financial systems where they have been historically and systematically disempowered and robbed of their privacy. In my role at EFF, I have been contacted by individuals and small businesses many times over the years who have had their financial accounts and payment systems restricted or shut down with little recourse, based on the whims of banking institutions rather than on the execution of laws. For example, Smashwords is one of the world's most popular hubs for self-published authors, and pays all their authors through PayPal. PayPal shut down their entire account[1] because some of their romantic fiction—to be clear, books of fiction with no photos—was too risqué for PayPal's tastes. With companies like Wells Fargo fraudulently opening millions of accounts and Equifax exposing the sensitive data of over 148 million Americans, American consumers have more reason than ever to be wary of sharing their financial information. Many blockchain innovations seek to use technology to protect the privacy and security of consumer data—and to keep financial information away from corporations that have proven they cannot be trusted with it.

While blockchain technologies alone cannot resolve this disempowerment, technological advances such as blockchain may well prove part of long-term solutions that empower technology consumers. Policymakers should view many blockchain innovations as a technological partner in the regulatory fight to defend consumers against wrongdoing by financial companies.

Secondly, policymakers should know that the human rights of privacy and freedom of expression are heavily implicated by many of the potential regulations of blockchain technology. For example,

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[1] Rainey Reitman, *Legal Censorship: PayPal Makes a Habit of Deciding What Users Can Read,* Electronic Frontier Found. (Aug. 21, 2018). Retrieved from https://www.eff.org/deeplinks/2012/02/legal-censorship-paypal-makes-habit-deciding-what-users-can-read.

ELECTRONIC FRONTIER FOUNDATION

EFF has pushed back against proposals that would prevent everyday technology users from protecting their financial transactions using privacy coins, or tokens that protect the privacy of their users.[2] We have also opposed proposals to regulate or ban the publication of open source software.[3] Attempting to prevent consumers from accessing technology that protects their individual privacy or from publishing free software raises a host of human rights issues, in addition to being contrary to the free speech and privacy protections enshrined in the Constitution.

A blockchain is a distributed ledger—a database that stores multiple copies of data across many computers in a network.[4] The first application of blockchain technology was Bitcoin. Bitcoin's promise was to revolutionize value as the Internet revolutionized information—to make it possible to send value across the globe digitally and securely, without needing a bank.

Traditionally, transferring values between parties required third parties like banks that maintained ledgers of transactions. Bitcoin cut out the multiple intermediaries that needed to update their ledgers and coordinate with each to process transactions, in favor of a single ledger that permanently records every transaction. That ledger is not maintained by a single entity, but rather stored and maintained by many computers working together in a network. [5] This "distributed

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[2] "Privacy coin" is a general term used to refer to a range of different blockchain-based tokens that have built-in protections for transactional privacy. Using cryptography, these privacy coins are designed to publicly verify transactions while not revealing the identity of the sender, the receiver, or the transaction amount. Two well-known privacy coins are ZCash and Monero. J. Frankenfield, *Zcash*, Investopedia (Mar. 12, 2019). Retrieved October 14, 2019, from https://www.investopedia.com/terms/z/zcash.asp.; J. Frankenfield, *Monero*, Investopedia (Mar. 12, 2019). Retrieved October 14, 2019, from https://www.investopedia.com/terms/m/monero.asp.

[3] Open source software is software that is published freely, so that anyone can make a copy, edit, or contribute to it. This so-called "free software" has been widely adopted and is now a primary, common form of expression for ideas that are implemented in software. Today, it is used widely across the Internet and Linux, the primary operating system used on Internet servers and which underlies the Android mobile operating system, continues to be maintained as a free software project contributed to by thousands of commercial companies, and tens of thousands of individual developers, volunteers, and academics. Read more about EFF's recent comments to HM Treasury describing the impact of banning the publication of open source software as part of blockchain regulation. Rainey Reitman, *EFF and Open Rights Group Defend the Right to Publish Open Source Software to the UK Government*, Electronic Frontier Found. (Aug. 16, 2019). Retrieved from https://www.eff.org/deeplinks/2019/06/eff-and-open-rights-group-defend-right-publish-open-source-software-uk-government.

[4] The National Institute of Standards and Technology defines "blockchains" as "[i]mmutable digital ledger systems implemented in a distributed fashion (i.e., without a central repository) and usually without a central authority. At its most basic level, they enable a community of users to record transactions in a ledger public to that community such that no transaction can be changed once published." Dylan Yaga, et al., *Blockchain Technology Overview*, NAT'L INST. OF STANDARDS AND TECH. (Oct. 2018), available at https://nvlpubs.nist.gov/nistpubs/ir/2018/NIST.IR.8202.pdf.

[5] "A blockchain can be public or private. In a public blockchain, anyone can create a public-private key pair and download a copy of the blockchain. . . . In a private blockchain, the membership of users on the

ledger" is called a "blockchain," because the ledger permanently and securely stores data by linking (or "chaining") blocks of data together through encryption.

The Bitcoin blockchain is a record of Bitcoin transactions,[6] but there are many other applications of this distributed ledger technology. As the legislature thinks about regulation, it is vital to recognize that future innovation in this space might be using these distributed ledgers for purposes beyond what we typically think of when we think of financial services.

One example is Filecoin, which applies blockchain technology to file storage. The legislature may remember a few months ago when huge swaths of the Internet—including popularly used tools like Slack and Github—were unavailable for hours.[7] That is because so much of the modern web are using a single service to store their data: Amazon Web Services. When an Amazon data center suffered an outage for several hours, multiple popular online platforms were unavailable to consumers. Filecoin seeks to decentralize file storage so that there is no single point of failure like the current system that is so heavily reliant on Amazon Web Services. Any one of Amazon's many smaller storage competitors or potentially even technically-minded individuals could offer storage through the same protocol, and the transactions made between application developers and these storage providers would be recorded on a blockchain.

While we cannot yet know how successful services like Filecoin will ultimately be, I offer it as an example of a blockchain project designed to serve consumer needs that are not met by modern tech companies, and that create a more decentralized—and therefore more resilient—web. As the legislature considers how to proceed, I urge you to keep front and center the interests of technology

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blockchain is controlled. A blockchain can be permissioned or permissionless, which is independent of whether the blockchain is public or private. A permissioned blockchain is one in which the permission of a user is assigned to them. . . . In a permissionless blockchain, all users have equal rights, with any one able to download the full blockchain and have an opportunity to potentially add additional blocks." Chris Jaikaran, *Blockchain: Background and Policy Issues*, Cong. Research Serv., R45116 (Feb. 28, 2018).

[6] The Bitcoin blockchain is the ledger that records Bitcoin transactions. Each "entry" in the ledger records a transaction, showing the "public key" (a string of numbers and letters similar to a username) of the user sending the Bitcoin and the user receiving the Bitcoin, the amount of Bitcoin being sent, and the time of the transaction. Each "public key" is associated with a "private key" (similar to a password) that enables the user associated with that public key to transfer the Bitcoin to other users. To "own" Bitcoin is simply to know the private key associated with a public key that has received Bitcoin.

[7] J. Swearingen, *When Amazon Web Services Goes Down, So Does a Lot of the Web*, New York Magazine (Mar. 2, 2018). Retrieved October 14, 2019, from http://nymag.com/intelligencer/2018/03/when-amazon-web-services-goes-down-so-does-a-lot-of-the-web.html.; C. Newton, *How a typo took down S3, the backbone of the internet*. The Verge (Mar. 2, 2017). Retrieved October 14, 2019, from https://www.theverge.com/2017/3/2/14792442/amazon-s3-outage-cause-typo-internet-server.

users, especially those under-served by existing technology companies who may benefit from future innovation.

EFF has developed a set of guiding principles to help regulators balance the needs for innovation, consumer choice, and consumer protection.

To summarize these principles:

Principle 1: Regulation should not undermine privacy-enhancing innovation in this space. The right to privacy is enshrined in the United States Constitution, in international human rights law, and in California's own Constitution. This state has long been a leader in defending consumer privacy and a bellwether state for bringing new privacy protections to consumers. California must uphold these consumer protections in the cryptocurrency space, ensuring that new innovations to defend consumer privacy can flourish.

Principle 2: Regulation should not chill future technological innovation that will benefit consumers. Though the blockchain ecosystem is still relatively young, there are already well-established companies with the resources to hire expert counsel and compliance officers to navigate state, federal, and international regulations. We want to ensure that these early entrants do not establish themselves and then pull up the ladder behind them. In the technology sphere, when existing services do not serve the needs of consumers, innovative new products come along to try to give consumers better choices. We must ensure that new services can continue to be created to serve all consumers, and that we do not merely entrench the big companies of today. As regulators enter this space, they should ensure generous on-ramps to give new services the time to build their products and find their market before having to navigate onerous regulatory burdens.

One important piece of this is ensuring regulations are technologically neutral. Attempts to write laws to capture the technological details of one specific cryptocurrency could have massive and unintended impacts on the market, such as prioritizing one type of technical solution over others or driving innovation away from a particular method of doing something.

Principle 3: Regulation should focus on custodial services. Custodial services—those entities that hold and trade tokens on behalf of users—are most likely to abuse consumer trust. In fact, they have already developed a sordid history of fraud and sloppy security practices. These companies need to be held accountable to ensure that they cannot defraud consumers. Regulators should focus their energies on crafting regulation that holds these bad actors that offer custodial services to account**.**

This includes ensuring that any regulation protects individual miners, merchants who accept cryptocurrencies, and individuals who trade in cryptocurrency as consumers**.** Cryptocurrency miners merely confirm transaction and maintain copies of a blockchain, offering computing power

to keep the network healthy and functional. They do not offer direct services to consumers and should be neutral actors—verifying but not interrupting or prioritizing any transactions. At this stage in blockchain's development, there is no reason for regulators to put compliance or regulatory burdens on miners. Similarly, everyday merchants who are offering consumers new choices by accepting cryptocurrencies for purchases, and consumers who are experimenting with using cryptocurrencies for commerce should not be burdened by additional regulation at this time.

Principle 4: Any regulation should recognize the important role of decentralized exchanges and other decentralized technologies in empowering consumers. Centralization of control creates brittle digital systems where a single point of failure can shut down commerce or communication. Much of the strength of the modern web comes from its decentralization—and many of the problems we see in technology space are a result of a handful of big technology companies having undue control over much of our digital experience. Blockchain technologies were built to be resilient and decentralized, and future innovation that advances decentralization – including decentralized exchanges – should be protected.

Principle 5: Regulations should not punish those who merely write and publish code. EFF fought to establish, and several courts have recognized, that writing code is a form of expressing ideas, similar to other forms of communication like writing music or books and thus is protected by the First Amendment. Policymakers must ensure that regulations aimed at blockchain technologies do not prohibit the publication or distribution of code or otherwise require parties to obtain a government license before publishing or distributing their code.

Thank you for allowing me to share my thoughts with you today. I look forward to continuing the discussion.

ASSEMBLY COMMITTEE ON BANKING AND FINANCE, SELECT COMMITTEE ON TECHNOLOGICAL ADVANCES

Joint Informational Hearing

"Virtual Currency Businesses: The Market and Regulatory Issues"

October 17, 2019, 10:00 a.m.

Rio Hondo Community College

Testimony of

Manuel Alvarez, Commissioner

California Department of Business Oversight

Introduction

Madam Chair Limón, Majority Leader, Calderon, and members of the committees & Rio Hondo community, I'm Manuel Alvarez, Commissioner of the California Department of Business Oversight a role to which I was appointed in May. Thank you for the opportunity to participate in this hearing about virtual currency, an emerging, rapidly changing industry.

The Department of Business Oversight licenses and regulates over 360,000 individuals and entities that provide financial services in California. The Department licenses and regulates money transmitters, issuers of payment

instruments, and stored value cards. As of June 2019, the Department had 102 money transmitter licensees who had a total of over 48,000 agent locations in California. Banking, credit unions, securities, and commodities are the other areas regulated by the Department that may be impacted by the virtual currency industry.

The Committees have asked that I provide insight and expertise related to virtual currency. Specifically, you requested information on: 1) consumer complaints about virtual currency fraud; 2) how current laws apply to virtual currency businesses; 3) requests from virtual currency businesses for regulatory clarity; 4) the Department's views on the Uniform Law Commission model regulatory framework; and, 5) the policy tradeoffs or implementation challenges that the Legislature should consider when contemplating regulation in this space.

I will be offering the Department's perspective on these issues.

I. Consumer Complaints Related to Virtual Currency Fraud

When the Department receives complaints regarding virtual currency, they are reviewed by our Enforcement Division to determine if the Department has jurisdiction to investigate. If not then we refer the complaints to the Securities and Exchange Commissioner or another agency that may have jurisdiction.

Currently, there are approximately 15 investigations pending in the Department's Enforcement Division and year to date 2019 the Department has received 21 complaints, 16 of which are against the same exchange for customer service

issues. In the past three years, the number of complaints the Department received regarding virtual currency fluctuated. Generally, complaints come in waves, based on the prices of well-known virtual currency, such as Bitcoin, and customer demand.

In 2018, we received 63 complaints related to virtual currency, most of which concerned customer service issues like delayed credit of deposits or delayed processing of transactions. This surge in complaints appeared to be related to the sharp run-up in demand for virtual currency around this time last year, worsening customer service response times. However, with respect to these particular complaints, the Department did not have jurisdiction to take action because they were customer service-oriented and not related to a violation of the securities or commodities laws.

In 2015, we issued a desist and refrain order against a company called US Fine Investment Arts, Inc. (USFIA) and three of the firm's executives alleging that they sold securities without a registration and misled investors in offering and selling the securities. The order requires USFIA and the officers to stop further violations. USFIA is based in Arcadia, CA. USFIA operated a multi-level marketing scheme that promised investors their money would be converted into Gemcoin - a virtual currency. DBO settled in December 2018 when the company agreed to stipulate to the desist and refrain order. It was estimated the fraud victimized hundreds of Californians and thousands nationwide.

The Department may have jurisdiction if one of our securities laws is being violated. For instance, a digital asset may be deemed a security if it is sold with the promise that the digital assets will gain value and the purchaser will get a profit in the future. Another example, if a sham crypto-exchange says a customer can buy bitcoin on their website but in fact they do not sell the bitcoin on the website, this is a fraud in the sale of the commodity.

When complaints are received related to consumer service issues or delays in processing of transactions where there is no intent to defraud, they may be referred to the California Attorney General's Office Consumer Law Section for review of unfair deceptive practices. If the complaint involves the securities or commodities law but we have no evidence the company is acting in California and no California complainant, then it is referred to the US Securities and Exchange Commission or the US Commodity Futures Trading Commission.

II. Application of Current State Laws

As of yet, the Department has not determined whether the buying and selling of virtual currency is covered under the Money Transmission Act or any other of the Department's laws.

The Money Transmission Act regulates 1) receiving money for transmission, 2) issuing stored value, and 3) issuing payment instruments. In order to regulate virtual currency under the Money Transmission Act, the Department would need to conclude that virtual currency is money or monetary value. To date, the

Department has not issued a formal order or legal opinion declaring any virtual currency to be a medium of exchange.

It is possible some transactions may fall under the Money Transmission Act. For example, stablecoin – a virtual currency pegged to the U.S. dollar – could be a form of stored value. Another example is an online "wallet" – a secure environment for long-term storage of virtual currency or fiat currency. But the Money Transaction Act would not apply to many other activities related to crypto-currency. And a more comprehensive analysis of the various activities & attended risks may be warranted.

III. Requests for Regulatory Clarity

In 2018, the Department received 23 requests from virtual currency businesses seeking regulatory clarity. So far this year we have received 18 requests for clarity and currently, 5 of those requests are still pending.

If the Department identifies an aspect of the business that falls under the jurisdiction of the Money Transmission Act, we provide written guidance to the requestor about the need for licensure. When the business plan does not implicate activity falling under the Department's jurisdiction, we issue a letter to the requestor informing that the business model does not appear to require licensure at this time but that the Department continues to study the virtual currency market.

Our written response letters to requestors are redacted in order to protect businesses' proprietary information and then published on our website, so anyone wanting to do business in this area can see what the Department's position is. Our response letters indicate that the Department does not regulate the purchase and sale of virtual currency, such as through a Bitcoin ATM. Our responses are generally issued with the caveat that this is an evolving area of law and that the Department's position is subject to change at any time.

IV. Uniform Law Commission's Model Regulatory Framework

In 2017, the Uniform Law Commission created the Uniform Regulation of Virtual Currency Businesses Act to license businesses that 1) exchange virtual currencies for cash, bank deposits, or other virtual currencies; 2) transfer virtual currencies among customers; or 3) perform certain custodial or fiduciary duties. The model Act does not propose regulating virtual currency itself or owners of virtual currency.

The proposed model proposes some consumer protections and could provide certainty regarding what entities and activities are covered or not covered. The model act states to promote innovation, as the registration option for lower volume virtual currency activity is supportive of startup companies.

But, the Department has several concerns regarding the Uniform Law Commission's framework. First, any regulatory structure must be tailored to California's consumer protection needs – for example, the minimum net worth requirement of $25,000 may not make sense across the board. By comparison,

money transmitters must maintain tangible shareholders' equity of at least $50,000, depending on their size. Second, this regulatory framework has not been enacted by any state and therefore is untested, which makes it difficult to anticipate how regulation will affect the virtual currency industry or consumers. Lastly, the virtual currency industry is evolving so rapidly that the model act may already be outdated or soon become outdated.

The Uniform Law Commission model is a good starting point for a regulatory framework for virtual currency businesses. But I think it's important to focus on opportunities we have to optimize existing laws and regulations so as to leverage the good work the department is already doing.

V. Policy Tradeoffs and Implementation Challenges

A predictable and scalable regulatory framework for virtual currency would pose benefits to all stakeholders in California, from consumers and investors, to the companies, on down to the Department as the regulator. Consumers and investors would enjoy increased confidence in their transactions knowing they are protected by appropriate law and regulation. Likewise, the Department and our regulated businesses would benefit by focusing our efforts on the important work of complying with a predictable set of expectations, rather than grousing about a dearth of clarity. Through all of this, California could help lead the way as an innovator in a nascent industry and may help stabilize some of the volatility associated with this asset class.

There would, of course, be challenges. As it stands today, the Department has already observed several risks associated with virtual-currency activities. Some complaints that we have received over the years identify various implementation-challenges including duplicate transactions, processing delays, and incorrect tax forms or other documentation.

There are other fundamentally pernicious risks that would need to be mitigated. Such risks may include: 1) bad actors absconding with customer deposits; 2) lack of appropriate cybersecurity systems to prevent theft of customer funds); 3) lack of appropriate business continuity planning to account for the loss of persons who hold blockchain keys to transact company assets; and 4) obscure or undisclosed fees to consumers or investors.

The encouraging news is that such risks are addressable and the Department has, for sometime, been addressing similar risks across various industries and products. In the case of *this* emerging industry, I think the key is balance: It is important not to be so restrictive or prescriptive as to inadvertently stifle an emerging technology and industry out of California; but no so hands-off as to encourage strident actors that would take advantage of California consumers and investors. Also, important to consider the ways in which CA's existing regulations might be harmonized so as to better apply to this and other emerging industries.

As such, I think the first step in creating a sensible regulatory framework around a new industry is to define the industry itself on a first-principles basis:

- What are the distinct products and services that comprise it?

- What are the attendant risks of each type of product or service?
- And how could each attendant risk be addressed through enacting law or regulation?

For example, the features and risks of an “initial coin offering” – roughly speaking, a method of capital formation through a digital asset – may not be the same as those of a “stable coin,” which is itself pegged to a stable currency or other asset.

After the industry and products that comprise it are cogently defined, then we might turn to the critical work of assessing existing laws and regulations for applicability. This would then help to identify legal or regulatory gaps that are tailored to the risks that a given type of cryptocurrency may pose to California consumers and investors.

Closing

In closing, I would like to thank the Committee for the opportunity to discuss the opportunities and challenges the Department sees with the cryptocurrency industry. So much of this innovation has been born here in California, and so many consumers, investors, and other stakeholders are in our state. The Department will be glad to offer our technical assistance on any policy consideration related to virtual currency.

California State Assembly

BANKING AND FINANCE AND LOCAL GOVERNMENT

ASSEMBLY MEMBERS LIMÓN AND AGUIAR-CURRY, CHAIRS

JOINT INFORMATIONAL HEARING

Monday, February 4, 2019
3:30 p.m. -- State Capitol, Room 444

Public Banks: An Examination of Public Banking at the Local Level

AGENDA

1) Welcome and Opening Remarks

   a) **Assembly Member Monique Limon,** Chair, Assembly Banking and Finance Committee

   b) **Assembly Member Cecilia Aguiar-Curry**, Chair, Assembly Local Government Committee

2) Overview of Public Banking

   a) **Honorable Fiona Ma**, CPA, California State Treasurer
   Tim Schaefer, Deputy State Treasurer, State Treasurer's Office

   b) **Jan Lynn Owen**, Commissioner, Department of Business Oversight

3) Benefits of Public Banking

   a) **Sushil Jacob**, Senior Attorney for Economic Justice, Lawyers' Committee for Civil Rights of the San Francisco Bay Area, California Public Banking Alliance

   b) **Dick Mazess Ph.D.,** Public Bank Advocate, Democracy Collaborative

4) Policy Considerations of Public Banking

   a) **Jason Lane,** Vice President, Government Relations, California Bankers Association

   b) **Honorable Dan Mierzwa,** Treasurer and Tax Collector, Yuba County

   c) **Honorable Jose Cisneros,** Treasurer, City and County of San Francisco

   d) **James Beckwith,** President/CEO, Fivestar Bank

5) Public Testimony

Joint Informational Hearing
Assembly Banking and Finance Committee
Assembly Local Government Committee

Public Banks: An Examination of Public Banking at the Local Level

Monday, February 4, 2014
3:30 pm, Room 444

1. **Hearing Goal.** The goal of this hearing is to provide information to members of the Legislature about public banking at the local level. Multiple studies have been conducted in recent years to determine the feasibility of forming public banks and address the following questions:
    - What is the history of public banking?
    - What are the associated benefits and risks?
    - Is it appropriate to utilize public taxpayer dollars in such a manner?
    - What restrictions should be placed on local public banks?
    - What services and products should local banks provide?

    To answer these questions, and to help inform any future legislative efforts, the Committees will hear from experts, practitioners, and other stakeholders.

2. **What is public banking?** A "public bank" is a national or state-chartered depository institution owned by a government entity.[1] Except for public ownership, other features and purposes of public banks are not universally agreed upon. When voicing support for public banks, proponents have cited the following potential benefits:
    - Providing capital at a lower cost than the private sector to preferred uses (e.g., public infrastructure projects, affordable housing, small businesses, unbanked/underbanked).
    - Reducing costs to the government for banking services.
    - The opportunity to invest public funds in a way that reflects the values of the electorate.
    - The ability to divest public funds from commercial banks that provide financing to industries that advocates do not like (e.g., fossil fuel producers, prison operators, gun manufacturers).

    Note: Although some proponents of public banking have stated that a public bank could serve the cannabis industry, the Committees decided that the cannabis banking problem is not within the scope of this hearing. Federal law related to cannabis adds layers of complexity that could obscure and overwhelm the underlying merits and challenges of public banking. The focus of the hearing will be on the intersection of public banking and local governments. For a thorough analysis of a public bank to serve California's cannabis industry, please see the report commissioned by the California Treasurer in 2018.[2]

[1] Theoretically, a public bank can be established at the federal, state, or municipal level, assuming a legal framework has been adopted by the appropriate governing bodies.
[2] https://www.treasurer.ca.gov/comm-external-urls/cannabis-feasibility-full-report.pdf

3. **Public Banks in Operation.** There is only one public bank operating at scale in the United States – the Bank of North Dakota (BND). BND was founded in 1919 by the state legislature to support the state's farmers. BND is the state's exclusive depository institution and also serves local governments, which can voluntarily elect to deposit funds in the bank. Importantly, BND does not compete with private financial institutions. Rather, it partners with local banks and credit unions. These private financial institutions originate the loans, apply to participate in one of BND's programs, and then BND provides capital to participate in the loan with the private financial institution.

   There are several examples of public banks operating outside of the United States. Germany's Sparkassen and Landesbanken networks serve consumers, businesses, and governments. The Japan Finance Organization for Municipalities provides funds to local governments in Japan. While international examples show that public banks are possible, the differences in regulatory and legal frameworks between countries may inhibit these examples from providing much information for how public banking could work in California.

4. **Recent Efforts on Public Banking.** On the heels of the 2007-08 financial crisis, renewed interest in public banking has sparked legislation or feasibility studies in state and local governments around the United States. To date, no state or local government has established a public bank. Feasibility studies often find significant start-up costs and high levels of financial and operational risk associated with public banks.

   California
   Two bills were introduced in the 2011-12 Legislative Session. AB 750 (Hueso) would have created a task force to study a public bank at the state level. The bill was approved by the California Legislature but vetoed by Governor Brown who said the matter was "well within the jurisdiction and competence of the Assembly and Senate Banking Committees." AB 2500 (Hueso) would have established a public bank at the state level. The bill was never heard in policy committee by request of the author.

   Los Angeles
   In 2017, the City Council of Los Angeles requested a report on the feasibility of a Municipal Bank of Los Angeles. The report was written by the Chief Legislative Analyst and submitted to the Council in February 2018. The report identified a number of risks associated with establishing and operating a municipal bank and necessary legislative changes prior to establishing a bank. Following this report, Council placed an initiative on the November 2018 ballot to amend the city charter as a first step to establishing a public bank. The initiative was rejected by voters with 44% voting "yes" and 56% voting "no".

   San Francisco
   The City and County of San Francisco established a task force in 2017, facilitated by the County Treasurer's Office, to investigate the feasibility of a municipal bank owned by the City. The task force has convened stakeholder meetings and solicited opinions from banking experts to inform its analysis and recommendations. The final report of the task force is expected to be published in February 2019.

Seattle
The City of Seattle commissioned a feasibility study that was published in October 2018. The report concluded that "creating a public bank in Seattle would be at best a long-term process, requiring numerous layers of regulatory review and eventual compliance with a restrictive slate of limitations on its capacity to lend and raise capital."

Washington
The state legislature provided $480,000 in 2018 to fund a feasibility study, which is ongoing. Separate from the feasibility study, the State Treasurer conducted a "study of studies" which analyzed twelve studies that had been produced by cities and states around the country. Based on that study, the Treasurer concluded that he does "not support public banking because of the higher risk and lower return on investment compared to the current private banking system." He stated that using taxpayer funds or state pension assets to capitalize a public bank "would be reckless."

5. **Local Government Finances.** Local elected and appointed officials are charged with a fiduciary duty to the public. They are responsible for guiding multi-million dollar county and municipal agencies that depend on numerous sources of revenues and have multiple layers of policy and management responsibilities. Understanding their financial fiduciary responsibilities is one of their most important duties.

   Many factors dictate how a local agency manages its funds, including: the amount of revenue the agency receives annually; the source of the revenue, whether it be property taxes, sales taxes, fee-based revenue, utility taxes, grants, loans, bond funding, etc.; restrictions on how these funds can be used; and, many other dynamics in which each local agency is accountable. No two local agencies manage their finances in the same way. In order to balance the individual agency needs, the State, both constitutionally and statutorily, has provided local agencies with decision making flexibility in how finances can be managed.

   Traditionally, large, commercial banks provide most of the banking services for local agencies. Agencies with larger budgets often require the services of these national banks due to the size and complexity of their banking needs. These banks are for-profit entities, and services are not free. Some local governments also receive banking services from credit unions and community banks. However, the amount that can be deposited in these entities is strictly limited, often making it more difficult and less efficient for local agencies to utilize the services provided by credit unions and community banks.

   Banks are subject to a number of requirements when they receive funds from local agencies. Requirements, such as federal insurance and collateralization, decrease the amount of risk local agencies assume when making investments. Local agencies are authorized to invest surplus revenues in many different types of financial mechanisms. However, due to the financial fiduciary duty that local officials carry, they are obligated to make reliable investments.

   Investing public dollars carries risk. For example, Orange County filed for federal bankruptcy protection in 1994 because of a $1.7 billion loss to its Investment Pool, a depository for County surplus and borrowed funds and funds of 196 other cities, school districts and special districts. Subsequent hearings of the Senate Special Committee on Local Government Investments

brought to light questionable and sloppy investment practices and lack of prudent oversight on the part of some local officials.

As a result of the hearings, the Legislature enacted a number of bills to increase protections and address these problems, including SB 866 [(Craven), Chapter 784, Statutes of 1995] and SB 109 [(Kopp), Chapter 749, Statutes of 1996], which, among other requirements:

- Provided that a county treasurer is a trustee and fiduciary subject to the prudent investment rule.
- Established a local investment oversight committee.
- Called for treasurers to render annual investment policy statements to their governing boards required to be considered at a public meeting.
- Defined permitted investment instruments that local agencies can invest in.

6. **Relevant Existing Law.** Creating a public bank at the state or local level in California would require changes to state law. Additionally, approval from federal regulators may also be necessary, depending on how the public bank is structured.

California Banking Law
State law provides for the formation of a corporation for the purpose of conducting a commercial banking business (Financial Code Section 1000 et seq.). In order to become a bank, a corporation must apply for a charter with the Commissioner of Business Oversight. State law does not specify if a government entity can receive a bank charter. New legislation could make such a specification. Alternatively, the Commissioner of Business Oversight could issue a legal opinion that clarifies existing law, but such an opinion could be challenged in the courts.

Local Agency Security
The Commissioner of Business Oversight administers the Local Agency Security Program (Government Code Section 53661). This law specifies that banks secure specified collateral to protect deposits received from local agencies (i.e., county, city, city and county, including a chartered city or county, a community college district, or other public agency or corporation in California). In order to make loans, a public bank holding deposits primarily from local agencies would need an exemption from the collateral requirements. Such an exemption would expose the local agency deposits to a greater risk of loss.

Financial Institutions Law
State law requires banks to insure deposits with the Federal Deposit Insurance Corporation (FDIC). The FDIC may not approve a public bank for acceptance into the deposit insurance program. If accepted, the public bank would be subject to supervision and regulation by the FDIC. State law could be amended to exempt a public bank from the FDIC insurance requirement. Such an exemption would expose local agency deposits (up to the FDIC insurance amount of $250,000) to a greater risk of loss.

Bergeson-Peace Infrastructure and Economic Development Bank Act
State law created the California Infrastructure and Economic Development Bank (the IBank) in 1994 (Government Code Section 63000 et seq.). The Legislature wanted a financing entity structured with broad authority to issue bonds, provide guarantees, and leverage state and federal funds using techniques that target public investment to facilitate economic development. The

IBank is not a depository institution and not a "bank" according to state law. Some proponents of public banking have proposed the conversion of the IBank to a depository institution. Such a conversion might allow the IBank to expand its existing programs and offer more low-cost loans to local agencies for infrastructure and economic development projects. The conversion of the IBank to a depository institution poses operational risks and implementation challenges that could negatively impact the effectiveness of existing IBank programs.

Federal Reserve Act
Federal law provides for the establishment of the Federal Reserve System. The law allows for state-chartered banks to join the Federal Reserve System. A public bank would need to be a member of the Federal Reserve System if it wants to access critical systems and networks that connect the commercial banking system. The law grants discretion to the Board of Governors of the Federal Reserve System to accept or reject an application based on the financial condition of the applying bank, the general character of its management, and whether or not the corporate powers exercised are consistent with the Federal Reserve Act. Even if state and local laws permit the establishment of a public bank, the public bank would still need approval from the Federal Reserve to connect with the rest of the banking system. Failure to receive approval from the Federal Reserve would severely impact a public bank's ability to operate.

7. **Additional Resources.**

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ASSEMBLY COMMITTEE ON BANKING AND FINANCE, ASSEMBLY COMMITTEE ON LOCAL GOVERNMENT

Joint Informational Hearing

"Public Banks: An Examination of Public Banking at the Local Level"

February 4, 2019, 3:30 p.m.
State Capitol Room 444

Testimony of
Jan Lynn Owen, Commissioner
California Department of Business Oversight

Introduction

Good Afternoon Chairwoman Aguiar-Curry, Chairwoman Limon, and members of the committees. I'm Jan Owen, Commissioner of the California Department of Business Oversight. Thank you for the opportunity to participate in this hearing about a familiar, but important, subject.

The Department licenses and regulates more than 360,000 individuals and entities that provide financial services in California. More pertinent to this discussion, our Division of Financial Institutions licenses and supervises State-chartered financial institutions, including 120 banks with assets that total more than $500 billion. We examine these banks every 12 to 18 months, or more often if deemed necessary, to ensure they operate safely, soundly and lawfully.

As Commissioner, I am the Administrator of the Local Agency Security Program. This Program reviews weekly and quarterly reports from approximately 158 depository institutions holding over $17 billion in California local agency deposits.

It is the Department's responsibility to ensure these deposits are adequately protected by the depository institutions. Additionally, our banking program examines state-chartered banks for compliance with the Local Agency Security Program, more specifically, to validate local agency deposits are properly identified, reported and secured.

In your written invitation to testify today, you have asked us to provide insight and expertise related to the municipal banking model. Specifically, you requested information on: 1) how the Department reviews and makes approval decisions on new bank charter applications; 2) how the Department oversees banks that accept deposits from local government agencies; 3) regulatory considerations unique to a bank that is owned and controlled by a local government agency; and, 4) the Department's views about whether a state-level depository institution should be subject to the Department's supervision and enforcement. I will be offering the committee the Department's perspective on the appropriate oversight of a depository institution owned by the state as well as our view on the concept of transforming the California Infrastructure Bank into a depository institution.

Testimony

I. Bank Charter Application Approval

One of a bank regulator's most important jobs is to evaluate applications to establish a new bank. These are known as "de novo" applications. The integrity of the banking system depends on this work being done with the utmost diligence.

The process involves a rigorous review of the proposed bank to determine whether it will have the capital, asset quality, management expertise, earnings capacity, and risk management profile required to succeed and serve the consumers and businesses in its community.

An application to establish a new bank may be approved only if the following criteria are met:

- The public convenience and advantage will be promoted by the establishment of the proposed bank.
- The proposed bank will have a reasonable promise of successful operation.
- The proposed bank is being formed for no other purpose than the legitimate objectives contemplated by the banking law.
- The proposed capital structure is adequate.
- The proposed officers and directors have sufficient banking experience, ability, and standing to afford a reasonable promise of successful operation.
- The name of the proposed bank does not resemble, so closely as to be likely to cause confusion, the name of any other bank in California.
- And, the applicant has complied with all the applicable provisions of the banking law and regulations.

In reaching its decision, the Department considers factors including the following:

- The character, reputation, and financial standing of the organizers and their motives in seeking to organize the proposed bank.
- The need for the new bank, giving consideration to the adequacy of existing banking and the need for further banking.

- The character, financial responsibility, banking experience, and business qualifications of the proposed officers of the bank.
- The character, financial responsibility, business experience, and standing of the proposed stockholders and directors.
- The adequacy of banking facilities to support its operations.
- The adequacy of capitalization to support the projected volume and type of business.
- The likelihood the bank will achieve and maintain profitability.
- The viability of the Business Plan given the economic condition, growth potential, and competition of the proposed market area.
- And, whether the bank is free from abusive insider transactions and apparent conflicts of interest.

II. **Local Government Agency Deposit Oversight**

Next, I will discuss how the Department oversees banks that accept deposits from local government agencies, which are public funds.

Our examinations play a key role in the supervisory process to ensure public funds are protected.

In particular, our examiners review the following:

- To ensure local agency deposits are adequately secured (collateralized); we validate the existence of waiver forms, which offset the amount of securities needed to secure those deposits. Local agency treasurers have

the discretion to waive the collateral requirement up to $250,000 (the maximum deposit insurance amount).

- To ensure the accuracy of weekly and quarterly reports submitted to DBO; we review the bank’s list of deposit accounts to validate the deposit information submitted to DBO.
- To ensure the accuracy of weekly and quarterly reports submitted to DBO; we review reports from the holders of the depository’s securities to validate the amount of securities pledged to local agency deposits.
- To ensure all local agency deposits are reported to DBO; we review the bank’s list of accounts for unreported local agency deposits.
- To ensure the amount of local agency deposits held by a depository institution do not pose undue risk to the institution; we review the depository institutions risk management, compliance and liquidity practices relative to local agency deposits.

III. Local Government Agency State Banking

A bank that is owned and controlled by a local government agency should be treated no differently than any other state-chartered bank licensed and supervised by the Department. Such an institution should be subject to the same state and federal laws, and examinations should focus on the same basic components, including capital, asset quality, management, earnings, liquidity, and sensitivity to market risk.

IV. State oversight of a depository institution owned by the state

The DBO would be the appropriate regulator of a depository institution owned by the State. This includes any circumstance in which the California Infrastructure Bank or any existing lending program is expanded by statute to become a state-level FDIC depository institution. Supervision and oversight by the DBO would not only be appropriate, it would be necessary. As with any other depository institution, it would be subject to the same state and federal laws. It would likely need to obtain FDIC deposit insurance and a master account from the Federal Reserve to be viable. Our examinations would cover the same components. In such a scenario, it would be vitally important to protect the deposits, the hard-earned money, of the people and businesses of California. The Department is the only agency with the knowledge and expertise to do that job.

Closing

In closing, the Department will be glad to offer our technical assistance on any policy consideration related to public banking. Thank you again for giving me the opportunity to testify. I would be happy to take any questions.

Joint Informational Hearing on Public Banking
Testimony of Sushil Jacob, Lawyers' Committee for Civil Rights
February 4, 2019

INTRODUCTION
Good afternoon, my name is Sushil Jacob, and I am a Senior Attorney at the Lawyers' Committee for Civil Rights of the San Francisco Bay Area. I am a participant in the San Francisco Municipal Bank Feasibility Task Force. Today I am speaking as a member of the California Public Banking Alliance.

WHY WE NEED PUBLIC BANKING
California is facing twin crises, which public banking can help to resolve. The first is the crisis of unaccountable Wall Street finance that takes our public dollars and invests them in fossil fuels, private prisons, arms manufacturers and predatory lending – which are antithetical to California's progressive values.

The second problem is the loss of California's local banking industry.
The data shows that we are losing local and community banks in California at a rapid scale.

- In 1994, there were nearly 500 banks headquartered in California.
- The Department of Business Oversight's website lists 116 remaining state-chartered commercial banks. The vast majority of banks that have disappeared are community banks.
- The loss of local banks means a loss of local relationships with bankers who understand the needs of the local governments and communities in which they are embedded.

CALIFORNIA PUBLIC BANKS CAN HELP in BOTH of these respects.

First, public banks will allow California cities and counties to create sound investments that will save them money and allow them to invest their public deposits in fiscally, socially and environmentally responsible activities.

Second, Public banks can save taxpayer funds that are currently going to big banks and instead use those funds to finance public goods such as affordable housing, transparent student loans, renewable energy, rebuilding after natural disasters, and local infrastructure projects such as schools, parks and roads.

Third, In partnership with local banks and credit unions, public banks can provide affordable loans and lines of credit to local small businesses and nonprofits, and provide a critical bulwark against displacement of community-serving anchor institutions. Public banks can increase the lending capacity of the local banking system through participation loans, by providing liquidity, and serving as regional bankers banks.

Joint Informational Hearing on Public Banking
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February 4, 2019

THE CALIFORNIA PUBLIC BANKING ALLIANCE

The California Public Banking Alliance brings together advocates based in nine cities and regions across the State, ranging from San Diego, Los Angeles, San Francisco, Oakland, Silicon Valley, up to Eureka. Our vision is a network of public banks that are owned at the regional, county and municipal levels. All of the member organizations of the Alliance are in various stages of advocating for public banks in our regions and cities. In San Francisco, where I am based, we are nearing completion of a feasibility study to submit to our Board of Supervisors, and we look forward to a robust discussion on the possible next steps to move this idea forward.

The California Public Banking Alliance is pursuing a charter-based approach to public banking where we are not seeking to legislate a bank, but rather provide a pathway so that localities can create them.

The Alliance's 2019 goal is to introduce legislation that creates a clear pathway for the Department of Business Oversight to license and regulate local public banks, which would be classified as special-purpose commercial banks—which would be separate legal entities from their public shareholders. These banks would have separate, independent boards of directors, staffed by banking professionals. We know this because the DBO, through its regulatory oversight, would require it. We are basing our legislation on what exists—the state commercial bank charter.

In order to facilitate the deposits of public funds into public banks, the legislation will allow counties to lend their credit to public banks, to allow pooled investment funds to invest in debt of public banks, and to allow public banks to receive local agency money. The legislation would also allow public banks to obtain deposit insurance that is satisfactory to the DBO Commissioner of the DBO. The legislation will require that, wherever possible, the public bank's retail services be conducted in partnership with local financial institutions.

We believe the charter approach to public banking enables our regions to be laboratories of public finance—one in which we allow localities to decide if they want banks, and how and when to launch them. By decentralizing authority to California's regions—we believe we are diversifying the risks of public banking, as well as the rewards. In our vision, public banks will be created to meet the particular needs of local economies—whether it is rebuilding after wildfires, financing affordable housing, or preventing displacement of local businesses and nonprofit agencies.

Joint Informational Hearing on Public Banking
Testimony of Sushil Jacob, Lawyers' Committee for Civil Rights
February 4, 2019

After consulting with the county treasurers, we no longer seek to amend the collateralization requirements for public deposits.

Our view of public banking is based upon the highly successful Bank of North Dakota and its relationship with the State of North Dakota, the local banking system, and the federal government. A few points on the bank of North Dakota:

1. **It is 100 years old.** This year the Bank of North Dakota celebrates its centennial anniversary. Founded in 1919, BND was formed as a way for the state to protect North Dakota farmers from out-of-state financiers who restricted access to credit and charged higher interest rates. Does this sound familiar?
2. **It is profitable.** BND recorded its 14th consecutive year of record profits in 2017. That year the state's return on its investment at the bank was an astonishing 17%. Over the last 20 years, BND has made $385 million in payments to the State's general fund. That works out to about $3,300 per family — meaning North Dakota households received $3,300 more in public services than they had to pay for through taxes.
3. **It is good for the economy.**
The Bank's operating policy requires that it be "helpful to and to assist in the development of state and national banks and other financial institutions and public corporations within the state **and not, in any manner, to destroy or to be harmful to existing financial institutions."**
BND partners with community banks and credit unions, increasing their lending capacity and providing local businesses with greater access to credit. As a result of their relationship with the BND, North Dakota has more banks and credit unions per capita than any other state. In fact, it has nearly *six times* as many local financial institutions per person as the country overall. While locally owned small and mid-sized banks and credit unions (those under $10 billion in assets) account for only 29 percent of deposits nationally, in North Dakota they have a remarkable 83 percent of the market.
4. **It beat the financial crisis.** BND avoids subprime lending and other risky behaviors typical in Wall Street banks. By operating prudently, it avoids the volatile swings of the market cycle, including the 2008 crisis. According to the Wall Street Journal, "In 2008, North Dakota's economy grew 7.3%, twice as fast as any other state except Wyoming, which grew 4.4%." A key priority for BND is to maintain a strong and stable balance sheet to protect taxpayer money.

Joint Informational Hearing on Public Banking
Testimony of Sushil Jacob, Lawyers' Committee for Civil Rights
February 4, 2019

California Infrastructure and Development Bank- IBank

Dick Mazess (Emer, Prof, of Medical Physics, Univ. of WI, Madison)

HISTORY: The IBank was set up 20 years ago as a revolving fund. With very limited funding it has provided: (a) a handful of small infrastructure loans (**a total of $600 million**, averaging $10 million), and (b) **a conduit for $36 billion** of tax-exempt municipal bonds for state agencies. In the last 5 years its Small Business Financing Center (SBFC) has provided **$1.5 billion of loan guarantees** to non-governmental financial institutions, including credit unions and CDFIs, for their loans to small businesses and farms

NEEDED CHANGES: This limited success was possible despite the legislatures withdrawal of IBank funding of $280 million in 2003 (because of the dot-com debacle). The IBank subsequently raised over $350 million from revenue bonds. Interest payment on these is 2/3 of expenses greatly limiting retained earnings. The State Treasury must invest in a bond replacing the external revenue bonds for which the state will receive interest comparable to a T-bill. **The legislature must authorize the IBank to become a depository with an account at the Federal Reserve**. *In only two years and with minimal expense the IBank , unlike proposed city banks or a state bank, would become a functioning bank not a bank in name only with expanded capacity for both municipal loans and loan guarantees.*

EXPANDED LOANS AND LOAN GUARANTEES: The above bond redemption would leave the IBank with over $400 million of tier 1 capital **allowing up to $4 billion of loans to low-risk public entities** (cities, counties, JPAs, pension funds but *not* individuals or businesses). The $1 billion/year of conduit bonds it presently processes (much like CMFA and CSCDA) could be replaced with loans at below market interest. Needed infrastructure could be financed with lower sales and property tax and more loan guarantees could be implemented by its SBFC division for small and medium sized businesses, farms, and for credit unions.

DEPOSITORY INSTITUTION: The important challenge will be to obtain sufficient short-term deposits to act as reserves for loans. The state, public pension funds, and municipalities could use the IBank as a money-manager for their deposits with **competitive** interest rates and low transaction costs. This also avoids the risky unregulated markets used by private banks (ie no swaps or derivatives). Short-term deposits over the term of the loan from each client would serve as partial reserves (compensating balances) for its own loan portfolio. Daily accounting of deposits will be used to adjust for the cost of required reserves, while excess reserves would be swept into accounts yielding higher returns. The payments of interest on each loan (minus its operational costs including the cost of reserves) would be added to the client account semi-annually. Thus a 3% loan (versus current munis at >4%) could yield the account over 1%. The loans would produce returns rather than expenses and do so at lower interest cost.

A CREDIT UNION FOR MUNICIPALITIES: "A public bank for public entities". Importantly interest payments on municipal loans are returned to the depositors account minus operational charges. The later includes a fee facilitating more loans and loan guarantees. This process will begin to reduce the bond interest (from sales and property tax) paid annually by municipalities to the wealthiest 2% of households. This "regressive taxation", currently at $25 billion, equals half the state personal income tax paid by that 2% annually. Even if IBank growth is restricted it would be a functioning model that instills public trust in a state bank that lowers interest rates, expands infrastructure, and minimizes transfer of muni bond interest to the wealthiest households.

Authorizations for the IBANK: The first three items need to be done short-term, and the next six once the transition to a depository institution is approved by the Federal Reserve.

Short-term

State Treasury to invest in a 5-year revenue bond (with interest rate comparable to a 5-year T-bill) to allow the IBank to redeem outstanding revenue bonds.

IBank to prepare application for a depository account at the Federal Reserve including a 3–year financial projection

Dept of Business Organization to issue charter as a state depository institution upon provisional acceptance by the Federal Reserve

Upon Approval as a Depository Institution

State Treasury to back deposits by public entities in the IBank with full faith and credit of the State of California (as per Bank of N. Dakota)

State Treasury to open account at the IBank to make it a money-manager and to provide overnight loans for maintaining its required reserves (in lieu of the Fed or FHLB window)

The upper limit of an ISRF loan is raised to $100 million and the annual total is targeted initially at $1 billion thereby meeting the current level of requests for infrastructure funding

The IBank to provide loans for at least $1billion annually of what were formerly "conduit bond" for state agencies

Revise CA Govt Code 63071(b) to raise the limit of outstanding IBank loans from $5 billion to $50 billion to allow for future growth

Raise the legal limit for IBank rate reduction bonds from $10 billion to $20 billion to allow for possible refinancing at lower rates