Protecting Credit Since 1916
American Financial Services Association

May 14, 2020

The Honorable Monique Limón
Chair, Assembly Banking and Finance Committee
State Capitol
P.O. Box 942849
Sacramento, CA 94249

**Re: Assembly Bill 2501 – COVID-19 Homeowner, Tenant, and Consumer Relief Law of 2020**

Dear Chairwoman Limón:

I write on behalf of the American Financial Services Association (AFSA)[1] to express our serious concerns with Assembly Bill 2501, the COVID-19 Homeowner, Tenant, and Consumer Relief Law of 2020, which would create substantial new requirements for creditors working with consumers in California. AFSA members share the legislature's goal of providing relief to borrowers facing financial hardship due to COVID-19 and its consequences, and they continue to work with borrowers to help them stay current on their accounts, keep their vehicles and homes during this emergency, and ultimately emerge from the crisis in the best financial condition possible. In fact, our members in the vehicle finance, mortgage, and traditional installment lending industries have already been offering California consumers unprecedented relief.

As drafted AB 2501 raises significant concerns for secured creditors that provide credit to consumers on agreed upon terms and based on the fundamental assumption that payment of the obligation is secured by collateral. Compromising the ability to enforce those transactions on their original terms may have longer term unintended consequences on credit markets, putting consumers, creditors, and their employees at risk far after the current crisis subsides. Because AFSA members have been providing relief to borrowers since the emergency began, such sweeping requirements are unnecessary and would only serve to divert resources away from providing direct relief to consumers and toward modifying systems for compliance with the bill's requirements.

**Constitutional Concerns**

The U.S. Constitution prohibits states from passing ex-post facto laws and laws impairing legally valid contracts.[2] Sales finance contracts and mortgage loans are based on the premise that they are

[1] Founded in 1916, the American Financial Services Association (AFSA), based in Washington, D.C., is the primary trade association for the consumer credit industry, protecting access to credit and consumer choice. AFSA members provide consumers with many kinds of credit, including direct and indirect vehicle financing, traditional installment loans, mortgages, payment cards, and retail sales finance. AFSA members do not provide payday or vehicle title loans.
[2] "No State shall . . . pass any Bill of Attainder, ex post facto Law, or law impairing the Obligation of Contracts . . . ." U.S. Constitution, Article I, Section 10.

secured by collateral. AB 2501's provisions would fundamentally compromise our members' retail installment sales contracts and mortgage contracts by effectively severing the contract from the secured collateral for an indefinite period of time. Leaving creditors without the ability to secure collateral as necessary would fundamentally impair their ability to stay in business and enter into future contracts. Further, the disruption of existing contracts and prohibition on accrual of interest creditors are legally due would be an unconstitutional taking in violation of the Fifth Amendment's Takings Clause[3] and impermissible without just compensation to our members.

**Risk to Credit Markets**

Since this emergency began, creditors have offered unprecedented relief to borrowers, including deferring monthly payments, waiving late fees, and temporarily self-imposing moratoriums on foreclosure of mortgages and repossession of vehicles. The relief available to consumers is based on each company's assessment of its own portfolio and offered within the constraints of existing master credit agreements (i.e. lines of credit that companies access to fund their own operations). As with other types of credit, these funds are available based on an assessment of the company's creditworthiness, which is determined, in part, by the quality of the company's loan portfolio that is securitized to raise the funds. For example, a portfolio with a large percentage of delinquent balances presents more risk and means a higher cost of credit for a company seeking to fund its operations. While depository institutions like banks and credit unions have access to funds, in part, through the deposits they hold, non-depository financial institutions, which make up a large segment of the vehicle finance market, rely on securitizations to fund continued operations.

Creditors have made relief available to consumers for more than 60 days, with companies of varying sizes offering payment extensions on contracts at five times the rate seen prior to the pandemic. As a result, these companies are already facing higher costs for the credit they access to fund operations, including employee salaries and benefits and corporate infrastructure. Importantly, these lines of credit are also accessed to provide new credit to consumer borrowers, who may now also face higher credit costs or even have difficulty finding available credit due to the risks associated with originating new accounts. On top of the higher costs associated with obtaining new credit, companies also face liquidity risks. Like all borrowers, these companies must repay creditors under the terms of existing contracts, and the continued indefinite nonpayment of consumer accounts contemplated under the bill's requirements could leave companies without the funds to meet these obligations.

Each creditor considered the impact on securitization agreements when assessing the extensive relief that has been provided up to now, and relief was offered within the parameters of these agreements. Without the ability to provide tailored relief that considers the effect on master credit agreements, the risk to creditors, consumers, and credit markets will remain.

[3] " . . . nor shall private property be taken for public use without just compensation." U.S. Constitution, Amendment V.

## Extended Covered Period

Various requirements within the bill text would apply through the length of the COVID-19 emergency and extend for an additional 180 days, or more. This lengthy extension would create significant hardships for creditors by imposing significant requirements for the indefinite length of the emergency, *plus* an additional 180 days.

The bill text states that "with forbearance, creditors are likely to realize greater long-term value because borrowers will be more likely to repay their obligations after the major disaster or emergency has subsided." As noted above, many creditors have already demonstrated a commitment to helping California customers through this unprecedented time by providing relief since the start of the COVID-19 pandemic. Extending the period of relief well beyond the state of emergency will prevent creditors from assessing the impact that providing such relief would have on their businesses and make it difficult to balance the relief available to customers. These limitations will prevent creditors from realizing whatever greater long-term value may exist in the customer relationships and will likely adversely affect credit markets, reducing credit availability and increasing its cost for consumers.

Extending the covered time period beyond the state of emergency will also present significant challenges under generally accepted accounting principles (GAAP) that require unpaid debt be charged off following a pre-determined number of days of nonpayment (e.g. 120). When any debt charges off, it has negative implications for both creditors and consumers. The proposed 180-day extension, combined with the fact that many companies began offering relief nearly 60 days ago, will leave accounts without payment for a significant period of time, even without taking into account the indefinite length of the emergency itself.

Moreover, while the bill seeks to avoid "downward collateral price spirals triggered by an increase in foreclosure or repossession activity," its blanket prohibitions and extended timeframes are much more likely to exacerbate that result, particularly with regard to motor vehicles. Motor vehicle prices are determined by the market and depreciate in value over time, meaning collateral prices will necessarily drop throughout the lengthy mandatory forbearance period. Vehicles that are ultimately repossessed after the legislative prohibition expires will flood the resale market, further reducing values. The burden of these falling prices would unfortunately fall on borrowers responsible for covering any resulting higher deficiency balances. The best way to prevent such a market disruption is to allow creditors to work directly with borrowers based on individual assessments of borrowers' needs.

## Financial hardship

Many of the bill's proposed protections are available to consumers facing financial hardship during the COVID-19 emergency. However, the parameters of what would constitute such a hardship are not provided—nor are they limited to hardship specifically related to the COVID-19 emergency—leaving AFSA members without the ability to determine whether a customer satisfies the bill's requirements. For example, would a customer's temporary or *de minimis* loss of income satisfy this requirement, even if that same customer has sufficient financial reserves to weather the income loss?

Importantly, creditors will not know that the consumer faces a hardship until notified by the consumer. To avoid confusion as to the creditor being notified of the hardship, this notice should be in writing, and a creditor should be authorized to request written notice to request confirmation of any notification provided orally. To allow creditors to determine whether the financial hardship is legitimate, the written notice should also include an explanation of the basis of the hardship. Such an approach would ensure that relief is available to and directed toward those consumers most in need.

In order to allow financial institutions to focus their relief efforts on those California consumers most in need, we respectfully request a clear standard of what constitutes a financial hardship and that notice of the hardship be documented in writing.

**Mandatory Indefinite Forbearance**

One of the many requirements across the bill's chapters is indefinite forbearance periods of varying terms depending on the credit obligation, mandatory upon consumer request. These one-size-fits-all mandates, while specific about the forbearance length, create much confusion regarding their applicability to consumers already receiving forbearance under existing relief programs. For instance, if a customer has previously received a forbearance due to COVID-19, would a creditor have to grant an additional forbearance for the length required by the bill, or would the length previous forbearance count toward the mandatory period? While many AFSA members have already created forbearance programs that they feel fit consumers' needs, if this provision is enacted without additional detail, it would leave creditors unable to gauge the legal requirements being imposed upon them. In no cases, should any forbearance trigger automatically upon consumer delinquency.

The bill's blanket forbearance requirement would also make it difficult for creditors to work with borrowers through existing relief and loan modification programs that allow a consumer to make an adjusted or partial payment if they can. Such programs are based on assessments of individual borrower needs and may allow a creditor to avoid charge off of a delinquent debt until the consumer is able to bring the account current. Compliance with the bill would require significant adjustments to existing programs and systems, and the time required to make these changes may mean delays in the availability of relief to consumers.

**Interference with Contractual Interest Accrual**

Sections 3273.14, 3273.31 and Section 3273.32 would prohibit fees, penalties, or additional interest beyond the amounts scheduled or calculated as if the borrower made all contractual payments on time and in full during the period of forbearance. Many creditors have already voluntarily waived late fees and deferment fees and continue to work directly with borrowers to provide relief to keep accounts current and adjust payment schedules to meet each borrower's financial situation. Conversely, the proposed prohibition on interest would represent an extreme interference by effectively dissolving valid contractual obligations and could create far-reaching unintended consequences.

California has a vital interest in permitting the enforcement of reasonable, valid obligations to ensure the existence of a robust credit market. Waiving interest accrual for all consumer accounts for an indefinite period of time as this emergency continues will inject immense amounts of uncertainty and risk into broader financial markets. Further, implementation of any interest prohibition for existing accounts would be near impossible given the major changes to existing systems that would be required. The time needed to modify and test systems to implement this type of change would not be possible in time to address the COVID risk. Given the size of creditors and portfolios making these adjustments manually would also not be possible.

**Vague Requirement to Evaluate the Ability to Make Payments**

Following the indefinite forbearance periods for both mortgages and vehicle-secured credit, the bill would require that creditors evaluate a consumer's ability to return to making regular payments. This vague requirement provides no standard for what such an evaluation would look like, particularly considering the financial impact of the extended forbearance that's been provided. Moreover, because the bill separately prohibits creditors from requiring additional documentation of a consumer's financial hardship, creditors have no way of even making such an evaluation.

**Repossession Moratorium and Vehicles at Risk**

Section 3273.30 would prohibit action to repossess a motor vehicle or provide notice of intent to repossess during the COVID-19 emergency and for the 180-day period following. We reiterate our significant concerns about the extended period stated above and believe that such a broad, indefinite, blanket prohibition is unnecessary given the unprecedented relief creditors have offered since the emergency began.

Most importantly, this prohibition includes no requirement of financial hardship or relation to COVID-19, making it ripe for the type of abuse that diverts resources from consumers must in need. Any restrictions on repossession should be restricted to borrowers facing demonstrated financial hardship who request such a relief within a specific limited timeframe, rather than throughout the indefinite state of emergency plus an additional 180 days.

A more limited timeframe is of particular importance for vehicle-secured credit, as these loans carry short terms of no more than a few years. For example, on a loan with a typical 5-year term, the length of the emergency plus 180 days, on top of the more than two months of relief already provided, could easily stretch for more than one fifth of the original term. For a depreciating asset, this extended period of time without payment or repossession is likely to ensure the downward collateral price spiral the bill warns against when such vehicles flood the market.

Additionally, we respectfully request that the bill be amended to clarify that it would not limit voluntary surrenders—which provide borrowers with the ability to voluntarily turn over a vehicle based on their own assessment of their financial situation and vehicle needs. Moreover, the bill should not prevent creditors from recovering vehicles at risk due to mechanics' liens, fraud, vehicles in impound lots in jeopardy of being sold, abandoned vehicles, seized vehicles, or in other instances where the collateral may be in jeopardy.

Leaving creditors without the ability to recover their collateral in instances where it may be at risk for reasons other than the COVID-19 emergency could cause a significant disruption in the vehicle finance market, with implications for larger financial markets due to securitizations and existing master credit agreements. We do not believe that the legislature intends to prohibit voluntary surrender or recovery of vehicles at risk.

Without significant changes, we believe the proposed legislation may prevent AFSA's members from continuing to focus on providing direct relief to those consumers facing hardship and could lead to significant disruption to credit markets. Thank you for your attention to this matter. If you have any questions or if AFSA can be of any further assistance to you as you move forward, please do not hesitate to contact me at 202-469-3181 or mkownacki@afsamail.org.

Sincerely,

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