Consumer Financial Services Update

Direct Lenders, Marketplace Lenders, Loan Brokers, and Student Loan Servicers Significantly Impacted by New York's Proposed Executive Budget

February 10, 2017

Overview

New York Governor Andrew Cuomo unveiled the New York State Executive Budget (Budget) for the fiscal year 2018 on January 17, 2017. While the official press release made no mention of any impact on the consumer financial services industry, a detailed review of the Budget reveals sweeping changes that dramatically expand the regulatory reach of the New York Department of Financial Services (DFS) over, among others, direct lenders, marketplace lenders, loan brokers, and student loan services. The changes proposed in the Budget would constitute a dramatic increase in the scope and burden of New York's already expansive regulatory regime governing the consumer financial services industry.

While the Budget is only proposed legislation, New York's legislature has historically supported increased regulatory scrutiny over the consumer financial services industry, leading us to believe the proposed amendments will likely be enacted in the future. We recommend that companies potentially impacted by the changes outlined below prepare for the eventuality that the proposed changes become law. A company that will need a license due to this legislation may wish to be prepared to file a license application as soon as these amendments become law due to the lengthy approval process currently required by the DFS for any entity seeking a license under its existing licensing statutes.

Below is a detailed analysis of the most significant changes proposed in the Budget.

Changes to the Licensed Lender Law

The Licensed Lender Law currently applies to a person engaged in the business of making loans in the principal amount of $25,000 or less to an individual for personal, family, household, or investment purposes, and in the principal amount of $50,000 or less for business and commercial loans, and charges, contracts for, or receives interest greater than otherwise permitted by law.

The new Budget's proposed changes to the Licensed Lender Law include:

1. Removing the interest rate trigger from the licensing requirement
2. Adding "business" and "businesses" to define the scope of the licensing requirement
3. Expanding the definition of "engaging in the business of making loans in New York" to include soliciting loans in the prescribed amounts and, in connection with such solicitation, making loans, purchasing loans or otherwise acquiring from others loans or other forms of financing, or arranging or facilitating the funding of loans

The changes relating to the Licensed Lender Law may be found here.

Potential Impact on Direct Lenders

Including consumer lenders, unsecured lenders, commercial lenders, manufactured housing lenders, and out-of-state state-chartered banks

The removal of the "greater rate of interest than the lender would be permitted by law" trigger and the addition of "business" in defining the scope of the Licensed Lender Law will have significant consequences relating to licensing and lending compliance for direct lenders not already regulated by the DFS.

Currently, the Licensed Lender Law does not provide a list of specific exemptions. As a result, creditors often rely on the interest rate trigger to avoid the licensing and compliance requirements that the law imposes. For example, a lender could make loans that assess interest at rates below New York's civil usury limit, which is 16% per annum, to avoid licensure and compliance.

Or, a lender can rely on a law outside of the Licensed Lender Law and New York's civil usury limit for its rate authority and thereby avoid the licensing and compliance requirements. For example, an out-of-state state chartered bank can export interest from its home state into New York without needing to be licensed or to comply with the Licensed Lender Law.

Similarly, an eligible manufactured housing creditor that makes loans relying on section 501(a)(1) of the Depository Institutions Deregulation Monetary Control Act of 1980, 12 U.S.C. § 1735f-7a(a)(1), can make first lien chattel-only secured loans without the need to be licensed or to comply with the Licensed Lender Law.

Finally, since certain business entities, such as corporations and limited liability companies, cannot plead civil usury in New York, creditors can make business purpose loans to these entities without needing to be licensed or to comply with the Licensed Lender Law.

With the proposed changes, these entities, along with any other creditor making loans below the applicable dollar thresholds, will need to rely on the DFS to adopt a regulation providing an exemption, which, except with respect to banks, may be unlikely. Loan brokers would also likely need to be licensed as lenders.

Once a creditor is subject to the Licensed Lender Law, the loans that it makes will be subject to the onerous restrictions that the law imposes. For example, as a matter of state law, the Licensed Lender Law only permits a licensee to charge late charges for precomputed loans and prohibits fees and charges that are not expressly authorized, including origination fees, prepaid finance charges, and points.

While purchasing or acquiring loans is added to the list of activities that trigger licensure/compliance, the proposed language appears to require licensure only for a purchaser or assignee that solicits loans in the relevant amount. The proposed changes should not reach a passive investor or secondary market purchaser that does not play an active role in the loan origination process. However, a court or regulator could take a broader view and disagree with this interpretation.

Potential Impact on Marketplace Lenders, other FinTech Companies, Merchant Cash Advance, and Factoring Programs

The proposed changes appear carefully designed to bring marketplace lenders and other FinTech companies operating by means of a bank partnership program within the scope of the Licensed Lender Law. The proposed changes would amend section 340 of the New York Banking Code to require a license for any entity that solicits consumer loans with principal balances of $25,000 or less, or commercial loans with principal balances of $50,000 or less and either:

(a) makes loans; or

(b) "purchases loans or otherwise acquires from others loans or other forms of financing, or arranges or facilitates the funding of loans" to New York residents or businesses.

The primary business model of marketplace lenders and many other FinTech companies involves both the solicitation and acquisition or purchase of loans, and thus the proposed changes would likely trigger licensing under the Licensed Lender Law if the principal balance thresholds are met. However, the language as currently drafted would appear to exclude secondary market loan purchasers that are not engaged in the solicitation of the loans at the origination stage.

Finally, we note that the inclusion of language relating to "other forms of financing" may be an attempt to regulate existing factoring or merchant cash advance business models. The DFS may view the recent New York case law deeming merchant cash advance programs to be loan programs to provide sufficient grounds for the DFS to take the position that lender licenses are required for such programs. If the proposed changes become law, we will seek additional clarity from the DFS on this issue.

Potential Impact on Student Loan Servicers

The bill would amend the Banking Law to add a new article that would require student loan servicers to be licensed by the Superintendent. The bill defines student loan servicers to include any person who accepts payments or communicates with borrowers with respect to the payment, status, or modification of any student loan, whether private or government, except for defined exempt entities. Exempt entities would include state and federally-chartered depository institutions as well as state or federal loan servicing instrumentalities, but it is important to note that the exemption would apply only to the licensing requirements, so exempt entities would still be subject to the conduct and other substantive requirements applicable to student loan servicers.

The conduct requirements include a list of prohibited practices, such as misrepresentation of amounts due by the borrower, misapplication of payments, and failure to communicate with an authorized representative of the borrower, as well as a number of "responsibilities" that the loan servicer must follow. Those responsibilities include accurate credit reporting, an affirmative duty to contact a borrower for instructions on how to apply a nonconforming payment, accurate and timely transfer of borrower information in the event of a servicing transfer to a new loan servicer, and a requirement for the new servicer to honor borrower benefits granted by the prior servicer, among other obligations that are similar to those found in mortgage loan servicing.

In addition, the bill would grant the superintendent the authority to promulgate student loan servicing regulations beyond the substantive requirements stated in the bill.

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If you need assistance in obtaining a consumer financial services license in New York or have questions regarding the issues raised by the proposed amendments, please contact one of the authors of this alert or another member of the firm's Consumer Financial Services Group.

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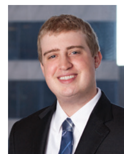

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