NEW YORK STATE
DEPARTMENT of
FINANCIAL SERVICES

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Statement of Maria T. Vullo, Superintendent
New York State Department of Financial Services
Prepared for Delivery at Public Hearing:
Practices of the Online Lending Industry
Albany, New York
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Good Morning Chairman Hamilton and members of the Senate Committee on Banks, Chairman Carlucci and members of the Senate Committee on Consumer Protection, Chairman Zebrowski and members of the Assembly Committee on Banks, Chairman Kavanagh and members of the Assembly Committee on Consumer Affairs & Protection, Chairman Thiele and members of the Assembly Committee on Small Business. Thank you for convening this hearing on the important topic, "practices of the online lending industry."

As Superintendent of the New York State Department of Financial Services (DFS), I appreciate the opportunity to appear today to offer DFS's views on the interaction between online lending practices and our current regulatory environment and to describe how DFS is responding to protect New York's consumers and financial institutions from certain predatory and unregulated practices that create an unlevel playing field for our state-chartered banks across New York State.

DFS regulates and supervises the activities of nearly 1,500 banking and other financial institutions with assets of more than $2.6 trillion and more than 1,400 insurance companies with assets of more than $4.3 trillion. DFS licensees include approximately 250 state-chartered banks, approximately 1,200 licensed financial entities and approximately 7,600 mortgage loan originators.

DFS strives for a regulatory environment that promotes industry innovation and strong consumer protections in equal measure. DFS regulates both depository and non-depository institutions. Traditional banking includes taking deposits and making loans, in a dual-banking system in which banks can choose either a federal or a state charter. We, of course, champion the state charter. For non-depository institutions, the states have been the sole regulators. These institutions include licensed lenders, premium finance companies, money transmitters and check cashers, among others. Many of these non-depository institutions are small businesses.

<u>DFS's Support for Innovation and Consumer Protection</u>

DFS has both supported and enabled innovation, while also protecting consumers by requiring that all companies operate in a safe and sound manner within the financial services marketplace and on a level playing field. In implementing regulations for the licensing and supervision of virtual currency entities, for example, DFS legitimized a promising emerging financial services technology, while also providing for both minimum capital standards and surety bond or deposit requirements based in each case on the specific risk factors of the entity. Earlier this year, DFS issued the first in the nation cybersecurity regulation requiring DFS regulated entities to establish and maintain a cybersecurity program designed to protect consumers' private data and ensure the safety and soundness of New York's financial services industry.

Since I became Superintendent about 15 months ago, I have actively sought to collaborate with fellow regulators and improve DFS's work streams through innovation and streamlining, while also vigorously protecting New York's consumers. Just recently we announced an innovation that will allow us to better supervise the money transmitter industry by coordinating with other states through the Conference of State Bank Supervisors (CSBS), the organization in which all 50 state banking regulators are members. DFS will be expanding our participation in the Nationwide Multistate Licensing System and Registry (NMLS) to include all non-depository financial institutions doing business in New York. NMLS is a secure, web-based, nationwide licensing system that allows companies to apply for, update, and renew their licenses conveniently and safely online. DFS currently participates in NMLS for mortgage banking and servicing, and, beginning July 1, 2017, we are expanding our participation to include money transmitters.

<u>Online Lending in New York</u>

More than two centuries of history prove that core banking activities thrive in a state regulatory environment such as ours – one that champions innovation while keeping the playing field safe, sound, and level for all, to the benefit of industry and citizenry.

One of the key protections for borrowers in New York is in Article 9, section 340 of the Banking Law – New York's Licensed Lender statute. Licensed lenders are non-depository institutions; they are not banks, which are regulated by DFS under other provisions of the Banking Law. As it exists today, Article 9 requires that a lender obtain a DFS license when the lender is making consumer loans of under $25,000 or personal business loans under $50,000 that carry an interest rate greater than 16%. New York State's usury laws currently cap interest rates at 25% for all licensed entities (often referred to as the criminal usury rate) and 16% for unlicensed entities (often referred to as the civil usury rate. Under section 340 of the Banking Law, if a lender is making more than an incidental number of loans as described to residents in New York, the lender must be licensed by DFS. This license helps ensure that the lender is complying with all applicable state and federal laws. This is especially important because 16% is a high interest rate and these are small dollar loan amounts that directly impact vulnerable consumers.

Because DFS conducts regular examinations of its licensed lenders, the licensure requirement helps identify and remediate market conduct violations in real time, to ensure that all lending complies with New York's usury laws and other consumer protections. The licensure requirement often deters violations in the first place. Licensure protects New Yorkers.

Many online lenders are engaging in lending activity in New York without licensure, which is of great concern to DFS. The fact that they utilize the internet – as do many of our state-chartered banks and of course our state licensed money transmitters – does not exclude them from New York's licensing requirements and consumer protections. Some of these online lenders are evading New York's protections by partnering with an out of state or a federal bank and disclaiming their true role as lender in order to bypass New York's usury laws and other consumer protections. This is to the serious competitive disadvantage of

New York's state-chartered institutions, including our community banks, which are subject to DFS's robust supervision and New York's laws.

New York's community banks typically retain both risk and a stake in the communities they serve, but online lenders do not. The so-called "marketplace lenders" often offer unsecured personal and business loans at high rates and fees, and either on-sell the loans or bundle and sell them as securitized products, leaving the consumer without recourse or DFS protections.

Expanding banking services to reach the unbanked and underbanked is a major concern and area of focus of mine at DFS. But unregulated online lending is not the solution to this important issue. While it may seem at first that the online lending industry is offering an attractive way to extend the reach of banking services to the underserved and offering more choices to consumers, online lenders that are actually preying on consumers is not the answer.

New York vigorously opposes back-door attempts to prey on consumers with payday loans. A payday loan is a relatively small, high-cost loan, typically due in two weeks and made with a borrower's postdated check or access to the borrower's bank account as collateral. Payday loans are designed to trap borrowers in debt and have been illegal in New York for decades.

As another example, DFS recently took action against a pension advance company resulting in the issuance of refund checks totaling $541,835 to 115 retired New Yorkers deceived by the company. DFS's investigation found that the company solicited and made loans to retired consumers exclusively over the internet, but was neither licensed to make loans nor to transmit money in New York. DFS's investigation uncovered that the company misrepresented that its "advances" in return for retirees assigning away years of their pension benefits were not actually loans at exceedingly high interest rates. In addition to the refunds, DFS required the company to pay a $500,000 fine, reduce the total amount owed by pensioners to the actual value of the lump sum that was advanced and forgive amounts due above that amount, resulting in forgiveness of more than $6.3 million across 292 transactions. As a result of DFS's actions, the company no longer operates in New York.

As this example shows, we need to address the consequences of an individual or entity's failure to comply with our licensure requirements. Under existing law, although unlicensed actors can be sanctioned by DFS for operating without a license, these license evaders seek to avoid DFS regulation and enforcement. In addition to being harmful to New York consumers, this anomaly is not fair to the individuals and entities that are duly licensed and are complying with New York law. I therefore strongly advocate that we close this loophole in the law so that our laws are enforceable against unlicensed entities to the same extent the laws are enforceable against our licensed entities. Such a clarification will ensure that DFS has the ability to fully protect New Yorkers from unacceptable and illegal market conduct.

DFS will continue to enforce our laws when necessary to ensure that companies that try to deceive them are held accountable. But, DFS enforcement actions by themselves are an insufficient response to the problem of unlicensed online lenders. Individual actions take time and cannot address the problem wholesale. Smart regulation is the answer.

Proposal to Amend Section 340 of the Banking Law

In calling this hearing today, you asked whether legislation could help address the online lending industry. I answer that question in the affirmative. There are several gaps in Article 9, Section 340 of the Banking Law that need correction. First, the licensure requirement only applies to lenders making loans that carry interest rates greater than 16%. This steep 16% rate was set in 1980 when interest rates were in the double digits and the Federal Reserve's short term rate was over 20%. Today, the Federal Reserve's short term rate hovers around 1%. DFS believes this 16% threshold for licensure must be reduced to adequately reflect the interest rate realities of today. All consumer loans of $25,000 or less or personal business loans of $50,000 or less that carry an interest rate greater than 7% should be licensed to do business in New York, because these low-dollar loans are where New York consumers are becoming victims to predatory practices.

Second, the definition of "making loans" in New York should be explicitly clarified to address conduct that is evading our laws, including online conduct. While DFS believes that current practices of online lenders violate existing New York law, legislative clarification would go a long way to address this problem. Where an entity solicits a loan, and also arranges or facilitates the funding of the loan, or ultimately purchases or acquires the loan, that entity is making a loan. Such an entity should be licensed as a lender in New York to engage in this business activity.

The Governor's proposed 2017-2018 budget included changes to Article 9 that would have addressed these two concerns. The proposal was negotiated with the Assembly and Senate. Though the proposal was not included in the enacted budget, I continue to believe that legislation is badly needed. As discussed during the negotiations, DFS recommends the interest rate floor for licensure be reduced from 16% to 7% and that the definition of "making loans" in New York be clarified to include situations where an entity, in addition to soliciting a loan, is arranging or facilitating the funding of a loan, or ultimately purchasing or acquiring the loan. Although the existing statute already covers this conduct, certain online lenders are relying on the absence of explicit language to justify their unlicensed conduct. We should provide that explicit language. This amendment will restore a level playing field for industry and protect consumers from predatory online lending practices.

Finally, in addition to the licensure gap posed by the online lending marketplace, the student loan servicing business is another market where technological innovation has illuminated the need for additional consumer protections. Servicers of student loans in New York are regulated by no one. They are not regulated by the federal government. California, Connecticut and the District of Columbia recently have passed legislation to regulate student loan servicers. I believe New York should act as well, to protect the 2.8 million New York student loan borrowers from harm.

The Governor included in his executive budget a proposal that would require licensure of student loan servicers. This proposal was modeled after the Connecticut and California proposals and is consistent with other New York licensure rules. We should now pass the legislation and not allow the objections of the actors that need to be regulated to deter progress for New York's students.

Thank you again for inviting me here today. I welcome the continued collaboration.