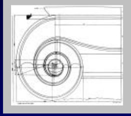

DREHER TOMKIES LLP

ALERT

FOR CLIENTS AND FRIENDS OF DREHER TOMKIES LLP

February 2, 2017

NEW YORK BUDGET BILL WOULD EXPAND SCOPE OF LICENSED LENDER LAW

On January 23, 2017, New York introduced a budget bill that proposes to expand the scope of New York's Licensed Lender Law (LLL). *See* 2017 N.Y.S.B. No. 2008. The LLL currently regulates and requires licensure of persons making consumer loans of $25,000 or less and commercial loans of $50,000 or less to individuals. If passed, the bill would expand the LLL to also regulate and require licensure of making commercial loans of $50,000 or less to business entities and not just individuals. In addition, the bill would expand the LLL to regulate not only persons that solicit and make loans in New York, but also persons who solicit and purchase or otherwise acquire from others loans or other forms of financing, or arrange or facilitate the funding of loans to individuals residing in New York or to businesses located or doing business in New York. If passed, the bill would become effective January 1, 2018. The bill could have a substantial impact on marketplace lending, bank partnership programs and traditional lending.

Applying the LLL to brokers and loan purchasers under the guise of a lending license is ill-advised for a number of reasons as explained below and the proposed amendments ill-conceived and poorly drafted.

<u>The LLL Was Intended to Apply Only to Lenders</u>

The New York legislature clearly intended the LLL to apply only to originating lenders as evidenced by the fact that the LLL:

- Requires a separate license for each location at which a licensee *makes* loans under the LLL. The plain meaning of "make" does not include brokering or purchasing loans.
- Provides penalties for licensees that violate the federal Truth in Lending Act, which applies to originating lenders who regularly extend credit, typically not including brokers and loan purchasers.
- Requires licensees to maintain records that are typically maintained by originating lenders. Requires an applicant to demonstrate that it has verifiable experience in the business of making consumer loans or similar *lending and credit evaluation* experience.
- Permits a licensee to purchase and collect loans made by other lenders only if, among other things, a record of such purchases and collections is kept separate and apart from the books and files relating to the activities of the licensed lender in making loans under its license.
- Permits a licensee to "make" certain loans and charge, "contract for and" receive interest thereon at a rate or rates "agreed to by the licensee and borrower."
- Requires a licensee to provide certain account opening disclosures.
- Prohibits a licensee from taking a lien upon real estate as security for any loan.

<u>Activities Triggering Licensure Are Overly Broad</u>

Applying the LLL to any person that "solicits" loans and "arranges or facilitates the funding of loans" without defining those terms creates uncertainty as to whether licensure would be required only of persons that perform traditional brokering services or also be required of persons, potentially including retailers, manufacturers, service providers (such as physicians) and servicers, that assist lenders with loan origination-related activities, including general advertising and transmitting application information to lenders. As drafted, loan purchasers could be required to obtain a license insofar as loan purchasers may "solicit" loans for purchase and "purchase or otherwise acquire" loans.

<u>The Proposed Territorial Scope Is Overly Broad</u>

Expanding the LLL to cover persons that engage in certain regulated activity with "businesses located or doing business in New York" may create unintended consequences. This language suggests that, for example, a Utah-based lender could be subject to licensure for making a loan to a Utah-based business merely because the business-borrower has a few New York customers or a one-person support office. Applying the LLL to the Utah-based lender under these circumstances might violate the commerce clause of the U.S. Constitution.

<u>Licensure is Unnecessary for Bank Servicers</u>

Subjecting brokers and others who provide services for banks to licensure in New York is unnecessary and fraught with potential conflict because federal banking regulators already require supervised banks to oversee their business relationships with third-party service providers in a manner that ensures compliance

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with federal and state law. Indeed, bank service companies are subject to bank and regulatory supervision as if they were actual employees of the bank they serve.

The Proposals are at Odds with Previous Interpretations of the LLL

The proposed amendments are a misguided attempt to exercise supervisory authority over brokers and loan purchasers that do business with bank lenders in New York and clearly at odds with previous guidance from the Department of Financial Services (DFS) and extant New York case law.

Regulating Loan Purchasers Would Encroach Upon the Federal Powers and Authority of Federal and Federally Insured Financial Institutions

The LLL does not specifically address the treatment of bank loans under the statute. As demonstrated in the *Madden* case, courts and consumers can misunderstand how state interest rate limitations and federal bank preemption interact in the context of loan purchases. The New York legislature should, at a minimum, amend the LLL to clearly exempt loans made by banks under federal authority so that the LLL does not conflict with those federal laws that authorize banks to charge interest pursuant to the laws of their home states. Other states (*e.g.,* Connecticut) have already enacted such exemptions.

Potential Consequences

Expanding the scope of the licensing requirement as proposed without addressing the issues described above will create uncertainty not only as to how the LLL applies to ordinary loan brokers and loan purchasers but also ancillary participants in traditional loan programs, like retailers, merchants and service providers like physicians who routinely “facilitate” loans. A licensing requirement should not be amended haphazardly in a budget bill.

Imposing significant, excessive and unnecessary burdens on or creating significant, excessive and unnecessary uncertainty for online marketplace lending participants and other nationally oriented programs at the state level (as other states can impose similar burdens or create further uncertainty) may cause industry participants to pursue more vigorously a federal fintech charter or other federal protections to avoid the jurisdiction of the DFS. Any new regulation should be judicious, coherent, tailored and separate, not poorly grafted onto an existing regime clearly targeted at other, distinctly different activities. ❑

✧ *Mike Tomkies, Chuck Gall and Susan Seaman*