NEW YORK STATE | Department of Financial Services

Online Lending Report

Maria T. Vullo
Superintendent
July 11, 2018

Andrew M. Cuomo
Governor

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The Honorable Andrew M. Cuomo
Governor
State of New York
Albany, NY 12224

The Honorable John J. Flanagan
Temporary President
New York State Senate
Albany, NY 12247

The Honorable Andrea Stewart-Cousins
Democratic Conference Leader
New York State Senate
Albany, NY 12247

The Honorable Carl E. Heastie
Speaker
New York State Assembly
Albany, NY 12248

Dear Sirs and Madam:

Enclosed is the 2018 online lending report required by Chapter 61 of the Laws of 2018, as a chapter amendment to Chapter 505 of the Laws of 2017. As the legislation required, this report includes, among other things, an analysis of the online lenders operating in New York including their methods of operations, lending practices, including interest rates and costs charged, the risks and benefits of the products offered by online lenders, the primary differences with products offered traditional lending institutions, and complaints and investigations relating to online lenders. This report also includes information regarding the Department of Financial Services' actions to protect New York's markets and consumers, and our analyses and recommendations based on the Department's experience and information gathered for this report.

I hope you will find the report informative and useful.

Sincerely,

Maria T. Vullo

Maria T. Vullo
Superintendent of Financial Services

cc: Melissa DeRosa, Secretary to the Governor
Alphonso David, Counsel to the Governor
Senator Elaine Phillips, Chair, Senate Banks Committee; Consumer Protection Committee
Assemblyman Kenneth Zebrowski, Chair, Assembly Banks Committee; Consumer Protection Committee

INTRODUCTION

On June 1, 2018, Governor Cuomo signed Chapter 61 of the Laws of 2018, as a chapter amendment to Chapter 505 of the Laws of 2017, requiring the New York State Department of Financial Services (the "Department") to study online lending in New York State and submit a public report of its findings and recommendations by July 1, 2018.[1] The bill requires that the report include, among other things, an analysis of the online lenders operating in New York, including their methods of operations, lending practices, including interest rates and costs charged, the risks and benefits of the products offered by the online lenders, the primary differences with products offered by traditional lending institutions, and complaints and investigations relating to online lenders.

The Department has knowledge and experience with online lending given its role as New York's financial services regulator. In addition, in order to gather data as provided in the bill, the Department prepared a "New York Marketplace Lending Survey" consisting of questions designed to explore online lending activities in New York.[2] The survey questions included those relating to business models and operations of the online lenders, quantity of New York consumers and small businesses served by them, including those that are unbanked or underbanked, specific loan terms, such as types of loans, loan amounts, loan duration, annual percentage rates ("APRs"), fees and charges, disclosures, underwriting standards, delinquencies, marketing and advertising, securitization practices, and complaints and investigations. The questions segmented borrowers into two groups: individual borrowers and small business borrowers, including those that are unbanked and underbanked. The information was requested for years 2015, 2016, and 2017.

Forty-eight institutions believed to be engaged in online lending activities in New York received the Department's Marketplace Lending Survey.[3] Additionally, the Department reached out to other stakeholders, including organizations representing consumer groups, banks and credit unions, and placed a banner link on the Department's website seeking public comments.[4]

[1] The bill followed a hearing held jointly by the Senate Standing Committee on Banks; Senate Standing Committee on Consumer Protection; Assembly Standing Committee on Banks; Assembly Standing Committee on Consumer Affairs and Protection; and Assembly Standing Committee on Small Business. The Superintendent testified at the hearing, as did members of industry and consumer representatives.

[2] The terms "online lending," "marketplace lending," or "alternative lending" are not specifically defined terms. However, broadly speaking, for the purposes of the Survey and this Report, online lending, marketplace lending, or alternative lending refer to the lending related activities of a sector of the financial services industry that mostly or solely operates online and uses investment capital, automation, data analytics and technology-enabled underwriting models for direct or indirect origination of primarily unsecured loans to consumers and small businesses. They operate under different business models, use various structures to fund such lending related activities, and while some are licensed and regulated by the Department, many remain unlicensed and unregulated by the Department, a fact about which the Department has expressed concern.

[3] The New York Marketplace Lending Survey was initially provided to a larger number of institutions but the Department learned that a number of recipients were not eligible for a variety reasons, such as having gone out of business, not lending in New York, or not engaged in online lending.

[4] The linked page listed topics to be addressed in the Report and stated, in part: "If you would like to share your views, comments or stories on any of these aspects of online lending, please send them to us." An email link was provided, and comments were requested by "no later than May 24, 2018." The Department received 12 comment letters and communications through that email link and otherwise.

Of the 48 institutions that received the Survey, the Department received responses from 35 institutions.[5] The quantity and quality of the responses from the 35 respondents vary, from sufficient, to reasonably sufficient, to less than sufficient, with some respondents reporting data only for a particular year and not for all three years, and not all respondents responded to every question in the Survey. Additionally, there was no uniformity in the way respondents responded to the questions. The respondents vary in size from small to some of the largest online lenders in the industry. The fact that a significant number of respondents either did not respond at all or did not fully respond to the Survey is a concern to the Department, as those companies seek to provide loans to New Yorkers without transparency or oversight. Of the 35 respondents, 28 institutions are not currently licensed by the Department and 7 are licensed by the Department.

The Department's analyses and recommendations below are based on responses and comments received, as well as the Department's own experience and due diligence, including various materials and reports reviewed.

BACKGROUND

(A) New York and Federal Laws and Regulations Relating to Consumer Lending and the Department's Supervision

New York laws and regulations relating to consumer lending seek to ensure that lending institutions that provide access to consumers are operating in a safe and sound manner and that consumers are protected. Under the New York Banking Law ("BL"), consumer lending institutions may be either banking organizations that are depository institutions, such as regulated banks and credit unions, or non-depositories, such as licensed lenders and sales finance companies.

The New York Banking Law, New York Financial Services Law and related regulations contain detailed provisions and requirements for licensing, examination, supervision and regulation of depository and non-depository institutions that are engaged in providing financial services and products in New York, including loans to New York consumers and small businesses, whether online or otherwise. For example, Article III of the BL governs the activities of banks and trust companies; Article VI of the BL governs the activities of savings banks; Article X of the BL governs the activities of savings and loan associations; and Article XI of the BL governs the activities of credit unions. Article IX of the BL governs the activities of non-depository licensed lenders, Article XI-B of the BL governs the activities of non-depository sales finance companies; Article XII-B of the BL governs the activities of non-depository insurance premium finance agencies; and Articles XII-D and XII-E of BL govern the activities of non-depository mortgage bankers and mortgage loan originators, respectively.

New York State chartered and licensed financial institutions, whether depository or non-depository, are subject to regular examination and on-going oversight, supervision and regulation by the Department to ensure safety and soundness of the institutions, compliance with applicable laws and regulations, protection of New York consumers, and reduction of systemic risk. With

[5] Of the 48 institutions that received the Department's Survey, 11 did not submit responses and an additional 2 submitted responses that were not responsive or usable.

respect to lending, major areas of focus of the Department's examinations are the institutions' underwriting standards, loan review policies, loan loss reserves, and compliance with New York consumer protection laws, including usury limits.

The Department supervises both depository and non-depository institutions. Specifically, the Department currently supervises 82 New York State-chartered community banks and 15 New York State-chartered credit unions.[6] The Department also supervises 17 New York State-licensed licensed lenders and 94 sales finance companies. All of the supervised banks are insured by the Federal Deposit Insurance Corporation, and all of the supervised credit unions are insured by the National Credit Union Administration.

Non-mortgage lending to individuals and small businesses by New York State chartered and licensed banks, credit unions, and other lenders exceeded $51 billion in 2017. This is more than 17 times the $2.98 billion in lending by the 35 online lending companies that responded to the Department's Survey. New York State chartered community banks have over $336 billion in assets, and State chartered credit unions have over $6 billion in assets. Those resources, and loan funding from insured deposit-based assets, are what allow banks and credit unions to continue lending throughout the economic and credit cycles.

Furthermore, the Department's Real Estate Finance Division is responsible for the oversight of 711 non-depository entities engaged in mortgage loan origination and mortgage loan servicing activities, as well as thousands of individual mortgage loan originators. The Department's oversight in this area extends to mortgage bankers, servicers and brokers. In total, during the first quarter of 2018, these entities originated more than $171 billion in loans and serviced loans with an outstanding principal balance of $189 billion. Over the last 10 years, following the financial crisis, the residential mortgage area has been subject to intense scrutiny, which has produced a number of important lessons learned, discussed in Section (C) below.

The safety and soundness examinations of depository and non-depository institutions include an evaluation of compliance or non-compliance with applicable laws and regulations, including the Department's applicable regulations. For example, examinations of New York regulated depository and non-depository institutions include a review of compliance with the Department's cybersecurity regulation, 23 NYCRR Part 500, and the Department's transaction monitoring and sanctions regulation, 23 NYCRR Part 504. Part 500 provides technical cybersecurity standards, and requires each regulated institution to have a strong governance framework to ensure accountability and a robust, up-to-date, risk-based cybersecurity program. This framework includes the submission to the Department of an annual certification of regulatory compliance, which is based on review of the cybersecurity program by the regulated entity's senior management. Part 504 requires a risk-based transaction monitoring and sanctions program containing certain attributes based on the operations and risk profile of each institutions to monitor and report suspicious activities and interdict transactions that are subject to OFAC sanctions or may violate federal and state anti-money laundering laws. This framework also includes submission to the Department of an annual certification of regulatory compliance by the regulated entity's senior management.

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[6] The Department does not supervise or oversee federally chartered financial institutions that may be engaged in lending activities in New York.

The Department exercises its consumer protection authority in numerous ways. In addition to safety and soundness examinations, the Department conducts consumer compliance examinations, which promote consumer confidence in Department-regulated institutions by monitoring institutions' compliance with consumer protection statutes and regulations through regular on-site examinations. The Department also conducts fair lending examinations to review whether financial institutions are treating New York borrowers fairly and equitably in all aspects of the credit application, underwriting, and servicing processes, pursuant to the authority granted to the Superintendent in Section 296-a of New York Human Rights Law. Section 408 of the New York Financial Services Law, among other things, authorizes the Department to enforce federal and state fair lending laws, as well as federal and state fair debt collection practices laws. In 2014, the Department issued a regulation to reform debt collection practices by debt collectors, including third-party debt collectors and debt buyers, and to provide greater protections for consumers. Additionally, the federal Consumer Financial Protection Act (Title X of the Dodd Frank Wall Street Reform and Consumer Protection Act) authorizes the Superintendent, as a state banking regulator, to pursue claims under the Act against entities that are state-chartered, incorporated, licensed, or otherwise authorized to do business in the State.

The Department also conducts Community Reinvestment Act ("CRA") examinations. The CRA is both a state and federal law that encourages financial institutions to meet the credit needs of all communities, including low and moderate-income areas. New York's CRA substantially mirrors the federal CRA and was adopted in 1978 largely in response to concerns about the existence of redlining of poor and minority communities by banking organizations during the 1960s and 1970s. Each institution is required to define its "assessment area," based on the location of its branches and the areas in which it makes loans. The CRA does not contain any formulas, dollar figures, or lending ratios that must be achieved by an institution in a specific community. Instead, what constitutes a satisfactory level of lending, investment and service by an institution is determined by a variety of factors, including opportunities presented by a specific community (i.e., demographic and economic factors); the institution's product offerings and business strategy; and institutional capacity, constraints, and other factors.

In conducting CRA exams, the Department seeks to ensure that regulated institutions are providing loans, investments and services to support the economic stability, growth, and revitalization of the communities they serve, concentrating on low-and moderate-income individuals, small businesses, and neighborhoods. The goal of the Department's CRA examinations is to ensure that borrowers and businesses at all income levels have access to appropriate financial resources at a reasonable cost, consistent with safe and sound banking practices, by analyzing loan data to assess how well banks serve the credit needs of their communities. The Department assigns each state-chartered bank a numerical CRA rating based on a 1-to-4 scoring system, representing a performance assessment of an institution's record of meeting community needs, as follows: 1 = outstanding record; 2 = satisfactory record; 3 = needs to improve; 4 = substantial noncompliance. During the most recent review period, the Department determined that nearly every state-chartered bank's performance was either outstanding or satisfactory. To date, online lenders are not subject to CRA requirements, which is a concern of the Department.

New York's usury laws provide an exceptionally important form of consumer protection overseen and enforced by the Department. The BL and New York General Obligations Law prohibit consumer loans under $250,000 with an annual interest rate higher than 16%,[7] which is often referred to as the "civil" usury limit. Subject to limited exceptions, under GOL § 5-511, loans offered in New York that exceed the 16% civil usury limit are void and unenforceable.

BL § 340 requires that a non-depository lender obtain a "Licensed Lender" license from the Department when the lender is making consumer loans of $25,000 or less for personal, family, or investment purpose, or of $50,000 or less for business or commercial purpose, if the loan carries an interest rate greater than 16%. However, under New York Penal Law §§ 190.40 and 190.42, New York-licensed or chartered depository and non-depository institutions are prohibited from making loans with interest rates exceeding 25% per annum, referred to as the "criminal" usury limit.[8] Exceeding the 25% interest rate is a felony.[9]

In contrast to New York chartered or licensed lending institutions that are subject to comprehensive regulation by the Department to protect consumers, high-interest lenders, often headquartered outside the State, pose a significant threat to New York consumers because they can evade New York's regulations and strong usury laws by operating exclusively online or by partnering with out-of-state or federal banks that are not subject to New York's laws. Many of these companies offer payday and other types of high-interest, short-term, small dollar loans that are illegal in New York. National banks that originate loans are permitted to charge the interest rate allowed by the state in which the bank is located pursuant to the National Bank Act, 12 U.S.C. § 85. Similarly, the Depository Institutions Deregulation and Monetary Control Act, 12 U.S.C. § 1831d(a), enables state-chartered insured depository institutions and insured branches of foreign banks to export interest rates allowed by the state in which the bank is located to out-of-state borrowers. Because of these laws, out-of-state or nationally-chartered banks may charge any rate allowed in the state they are located in and may import that rate into New York State.[10] Importantly, these rates apply to national or state-chartered banks, but they do not apply to non-banks, such as non-depository lenders.

(B) Payday Loans

Payday loans are short-term, high interest loans that typically are an advance on a paycheck and due on the borrower's next payday. The interest rates, which violate New York's usury limits, can reach as high as 400% on an annual basis. Payday loans often drive consumers into a "cycle of debt" because those who take out payday loans frequently find themselves quickly behind and unable to get ahead of the costly loans. Borrowers often must obtain new payday loans to repay previous ones because of the high interest rates and fees, creating a cycle of extremely high debt with onerous payment terms. One study reported that the median payday loan borrower took out

[7] N.Y. BANKING LAW § 14-a (maximum rate of interest is 16% per annum); N.Y. GEN. OBLIG. LAW § 5-501(6)(a) (for loans greater than $250,000, criminal but not civil usury laws apply).
[8] The 25% criminal usury limit does not apply to loans of $2,500,000 or more. N.Y. GEN. OBLIG. LAW § 5-501(6)(b).
[9] N.Y. PENAL LAW §§ 190.40, 190.42.
[10] Interest rate rules vary among states: while New York has strong usury laws, states such as Utah and Delaware have no interest rate limits for consumer loans.

10 loans in a year and paid a total of $458 in fees.[11] While some consumers use payday loans at low or moderate levels, a majority of payday borrowers use the loans on a long-term basis, needing new loans to repay old ones.[12]

The high cost of payday loans is not the only threat to consumers—payday lenders often operate in a regulation-free environment that lends itself to other exploitative behaviors. In this regard, online lending is particularly challenging because lenders may be incorporated offshore or claim an affiliation with a Native American tribe, enabling the lender to seek to insulate itself from the application of state laws because of the tribe's claimed sovereign immunity. Similarly, a lender may seek to "partner" with out-of-state or nationally-chartered banks, purportedly enabling the importation of high interest rates into New York. The Department is exceedingly concerned with efforts to avoid regulation and New York's ban on payday lending.

Not surprisingly, many consumers who take out loans online report receiving threats from online lenders, including lenders contacting borrowers' families, friends, and employers. Consumers often are unable to ascertain where the contacts and threats come from—whether from the online payday lender, debt collectors, or fraudulent entities that purchased borrower information from lead generators—issues common with online payday loans, where consumers electronically submit sensitive personal and financial information that can easily be mishandled or abused, and sold to other online entities. Consumers also report that lenders or their collection agents have threatened to have borrowers arrested, a tactic reported in recent complaints to the Department and other agencies. The Department investigated similar threats and tactics in its investigation and enforcement action against National Credit Adjusters, LLC, a company that purchased and collected on consumer debts resulting from small-dollar consumer loans, including usurious payday loans, and which the Department found to have engaged in unlawful debt collection practices.

It also has been reported that payday lenders and their affiliates have defrauded consumers and mishandled their personal information. More than 30% of consumers in one survey reported that they were contacted about a debt they did not owe, and nearly 40% reported that their personal or financial information was sold to a third party without the borrower's knowledge.[13] The Department's enforcement action against Blue Global LLC, discussed further below, confirmed that this is a problem in New York: the Department found that Blue Global advertised and solicited New York consumers for high-interest payday and installment loans through a number of websites that it owned or operated by having consumers provide sensitive personal and financial information, including Social Security numbers, birthdates, and driver's license numbers, and then providing that information to Blue Global's network of payday lenders, lead aggregators, and other third parties. Despite public assurances that it would protect consumers' personal information, Blue Global sold the information to third parties without taking protective measures and without requiring any protections from the purchasers.

[11] CFPB, *Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings*, 22 (2013), https://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf.
[12] *Id.* at 43.
[13] PEW CHARITABLE TRUSTS, "Fraud and Abuse Online: Harmful Practices in Internet Payday Lending," Fig. 4 (Oct. 2014), http://www.pewtrusts.org/~/media/assets/2014/10/payday-lending-report/fraud_and_abuse_online_harmful_practices_in_internet_payday_lending.pdf.

Payday borrowers also experience unauthorized transactions, including lenders withdrawing funds from consumers' accounts without their consent. In several instances, the Department has learned of lenders charging New York consumers high upfront fees, often in the hundreds or thousands of dollars, for loans that consumers never received; and the lenders did not refund those fees.[14] New York consumers also have complained that lenders placed loan information from other consumers in their online accounts,[15] failed to provide consumers with copies of signed contracts or other important information,[16] and opened accounts in consumers' names without their knowledge.[17] Other consumers have reported an alarming scheme in which lenders require borrowers to put money on prepaid cards to receive loans and then fail to provide the loans or issue refunds.[18]

Such troubling practices are not limited to consumer loans: small businesses, which often are run by sole proprietors, also are targeted for high-interest loans. Finding and affording a loan can be challenging for many small businesses because, historically, costs for depositories to extend small business loans are high compared to the potential returns on those loans. Even when small businesses obtain loans from traditional lenders, they frequently do not receive all the financing they seek. Though banks remain the dominant source of credit, small businesses are increasingly turning to online lenders and lending platforms to obtain funds and lines of credit.[19] Such businesses often lack the financial and legal savvy to understand the long and complicated terms in the loan agreements provided by lenders, making them easy targets for exploitative practices.

Like consumer loans, small business loans often have high interest rates. Online lenders that lend to businesses feature interest rates that can be much higher than traditional lenders. One report on California small business lending found the average interest rate for small business loans was 94%,[20] while another report reviewing various online lenders found lenders reported ranges of interest rates that exceeded New York's interest rate caps.[21] Small businesses have reported dissatisfaction with their online loans because of both high interest rates and unfavorable terms that are not often clear to the owners. Exacerbating these problems is that some existing consumer protection laws do not apply to small business loans. For example, the Truth in Lending Act and its implementing regulation, Regulation Z, the primary federal law governing consumer credit, require certain disclosures to inform consumers of the cost of credit, but specifically exclude

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[14] Consumer Assistance Unit, DEP'T OF FIN. SERVS. (complaints on file with DFS).

[15] CFPB, Consumer Complaint Database, Complaint No. 2723232 (2017).

[16] CFPB, Consumer Complaint Database, Complaint No. 2768198 (2017).

[17] CFPB, Consumer Complaint Database, Complaint No. 1996699 (2016).

[18] Consumer Assistance Unit, DEP'T OF FIN. SERVS. (complaint on file with DFS); CFPB, Consumer Complaint Database, Complaint No. 2663835 (2017).

[19] FED. RESERVE BANKS OF ATLANTA, BOSTON, CLEVELAND, DALLAS, KANSAS CITY, MINNEAPOLIS, NEW YORK, PHILADELPHIA, RICHMOND, ST. LOUIS, & SAN FRANCISCO, *Small Business Credit Survey 2017*, 10, (2018), https://www.fedsmallbusiness.org/medialibrary/fedsmallbusiness/files/2018/sbcs-employer-firms-report.pdf).

[20] OPPORTUNITY FUND, *Unaffordable and Unsustainable: The New Business Lending*, 4 (May 2016), https://www.opportunityfund.org/assets/docs/Unaffordable%20and%20Unsustainable-The%20New%20Business%20Lending%20on%20Main%20Street_Opportunity%20Fund%20Research%20Report_May%202016.pdf.

[21] Julapa Jagtiani & Catherine Lemieux, *Economic Perspectives: Small business lending after the financial crisis: A new competitive landscape for community banks*, FED. RESERVE BANK OF CHICAGO, 14, tbl. 2 (Mar. 2016), https://www.chicagofed.org/publications/economic-perspectives/2016/3-jagtiani-lemieux (stating certain lenders' reported annualized percentage rates for small business loans ranged from 8–32% and 14–36%).

extensions of credit for a business or commercial purpose, or if made to other than a natural person. Moreover, in New York, businesses may not allege usury as an affirmative claim and may not raise a defense of civil usury; they are limited to raising a defense of criminal usury in an action for repayment.[22] As a result, businesses may get caught in high-cost loans and experience more difficulty extracting themselves, particularly where the lending institution is not regulated.

(C) Lessons from the Financial Crisis

We have seen what can happen when basic guardrails are not put in place around consumer lending. During the financial crisis, unfettered mortgage lending led to the most severe economic downturn since the Great Depression. Mortgage underwriting standards declined gradually, with lenders offering increasingly risky loans to borrowers. Automated loan approvals led to an increased number of mortgage loan originations without any meaningful underwriting review and documentation. The originate-to-distribute model—originating loans to be securitized and sold to investors—minimized the incentives for originators to properly underwrite mortgage loans. In essence, loans were made to be sold to someone else.

In hindsight, many of the contributing factors to the crisis are obvious. For many, mortgage loans underwritten based on a teaser rate that would expire after a couple of years were simply unsustainable. A dependence on continuous refinancing at teaser rates was the only way many borrowers could keep their homes. When housing prices started to trend down, refinancing options disappeared. As teaser rates expired, borrowers found their adjusted mortgage rates beyond their means. Increasing defaults led to a tightening of credit and further declines in housing prices. In short, the failure to underwrite mortgage loans that borrowers could be reasonably expected to repay led to a cascading series of failures that created the worst financial crisis in recent history. As a result, 5.5 million American jobs were lost and the unemployment rate hit a 30-year high of 10.1%. U.S. households lost on average nearly $5,800 in income and in excess of a total of $3 trillion in real estate wealth. The combined peak loss from declining stock and home values totaled nearly $100,000, on average, per U.S. household, from July 2008-to-March 2009. The downturn underscored the importance of regulatory reform to reduce the likelihood and impact of any future financial crises.

While many of the missteps leading to the crisis are obvious in retrospect, there were some who pointed out these issues when there was still a chance to change course. When that occurred, any attempt to change the regulatory oversight of the most predatory loans was met with three basic critiques: it was asserted that (1) regulation would only destroy these new, innovative products (the same logic was used to support the deregulation of swap agreements in the Gramm-Leach-Bliley Act of 1999); (2) new underwriting models supported additional access of credit; and (3) regulation would stifle the flow of credit to people who needed it most and/or would deprive borrowers with low or no credit of the choice of taking on a product they could not afford to

[22] N.Y. GEN. OBLIG. LAW § 5–521(1) (no corporation can interpose defense of usury in any action); *id.* § 5–521(3) (corporation can interpose defense of criminal usury); *Colonial Funding Network, Inc. for TVT Capital, LLC v. Epazz, Inc.*, 252 F. Supp. 3d 274, 279 (S.D.N.Y. 2017) ("New York law … allows a corporation to assert criminal usury as a defense, but not as a claim for affirmative relief."); *Cullen v. Steinberg*, No. 08-6202, 2010 WL 2540937, at *8 (S.D.N.Y. June 22, 2010) (finding loans to corporations not generally subject to New York's civil usury laws and collecting cases).

repay.[23] Unfortunately, it took the clarifying effects of the crisis to move federal and most state governments to impose basic consumer protections.[24]

New York moved quickly to redress some of the worst abuses of the crisis, enacting Banking Law Section 6-m, "Subprime home loans."[25] Among other things, Section 6-m requires a lender to make a reasonable determination of the prospective borrower's ability to repay the subprime loan, prior to making such loan. The law also requires lenders to advise borrowers to "… consider financial counseling prior to executing loan documents" and for borrowers to be given a list of housing counselors maintained by the Department.

The federal government subsequently moved to protect against the predatory practices leading up to the financial crisis, enacting a wide range of reforms. Similar to New York, the federal government enacted its own ability to repay rule as part of the Dodd-Frank Act. The federal rule established minimum underwriting standards and provided borrowers with a right to sue their lender if the lender failed to take proper steps to assess the borrower's ability to repay. The ability to repay rule effectively ended lenders' ability to make "low-doc" or "no-doc" loans. The law further limits the ability of lenders to use teaser rates to mask the true cost of a mortgage, requiring that lenders assess the borrower's ability to repay the loan over the long-term.

The mortgage crisis is a good reminder that oversight and regulation is necessary to avoid turmoil in our financial markets. The subprime mortgage crisis was a result of too much borrowing and

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[23] Opposing guidance on "nontraditional mortgage products" proposed by federal regulators in 2006, the American Bankers Association wrote that "the guidance overstated the risks and ...goes far beyond any previous regulatory restrictions on these mortgage products, without a significant showing that the risks in these mortgage products has materially changed since they were created over two decades ago. We believe that this is an overreaction on the part of the Agencies that will greatly restrict the availability of these mortgage products to knowledgeable consumers who want them…."

[24] In 2004, the Office of the Comptroller of the Currency was an opponent of stricter state laws governing subprime mortgages, testifying as follows:

> However, these state and local law approaches effectively ban loans based on certain loan terms. They generally prohibit certain mortgage loan terms and impose extra compliance obligations when certain other loan terms or conditions are present. They introduce new standards for subprime lending that are untested, sometimes vague, often complex, and, in many cases, different from established and well-understood federal requirements. They also create new potential liabilities and penalties for any lender who missteps in its efforts to comply with those new standards and restrictions. These laws materially increase a bank's costs and compliance and reputation risks, especially in connection with risk-based pricing to the subprime market.

Statement of Julie L. Williams, First Senior Deputy Comptroller and Chief Counsel, before the U.S. House Subcommittee on Oversight and Investigations, Committee on Financial Services, on OCC's preemptions rules, Washington, D.C., January 28, 2004.

[25] Before the crisis, New York was a leader in the fight against predatory lending. In 2002, the state enacted Banking Law Section 6-l, "High-cost home loans," in an effort to combat some of the worst practices in the market. Section 6-l defined high-cost loans and created basic consumer protections, including prohibitions on negative amortization loans and excessive balloon payments. Moreover, the law required any lender processing an application for a high-cost loan to provide a home ownership counseling notice – a concise statement advising the borrower that he or she (i) had applied for a high-cost loan, (ii) should shop around for a different loan product, and (iii) should consult with a credit counselor or financial advisor before taking the high-cost loan.

flawed financial modeling. During favorable economic times, home prices skyrocketed, and banks offered easy access to money, and borrowers got into risky mortgages and qualified for mortgages with little or no documentation. Unfortunately, the economy took a turn for the worse, home prices stopped rising and started falling, borrowers who bought more than they could afford stopped paying and, to make matters worse, borrowers' monthly payments increased as their interest rates rose, resulting in many borrowers losing their homes and their livelihoods. It is imperative that regulators today take actions with these lessons in mind, and not respond simply to a positive economic environment without adequate stress and risk testing.

(D) New York's Leadership in Consumer Protection

New York has been a leader in enforcing its strong usury laws against lenders that are engaged in lending activities in violation of New York's usury limits, including payday loans. The Department has taken a multi-pronged approach to protecting New York consumers from payday loans and the services associated with advertising, facilitating, and processing such loans.

In 2013, for example, the Department commenced an investigation into payday lending by online companies based on consumer complaints. In February 2013, the Superintendent issued a circular letter warning debt collectors that they are prohibited from collecting on illegal payday loans in New York, including usurious payday loans offered to or made in New York online. In August 2013, the Department sent letters to 35 online companies that were offering payday loans to New York consumers, demanding that they cease and desist from offering and originating illegal loans in New York. The Department also sent cease-and-desist letters in April 2014 to 20 additional companies it identified as illegally promoting, making, or collecting on payday loans to New York consumers. Twelve of those companies appeared to be using the debit network to collect payments. The Department has to date sent cease-and-desist letters to a total of 55 online payday loan companies, more than half of which have represented to the Department that they stopped lending to New York consumers. Others have ceased operating in the years since the Department's letters were issued, were subject to enforcement actions by other government agencies, or changed their websites to prevent New York residents from applying for loans. In the years since the Department has taken these steps, the number of consumer complaints about payday lending has decreased significantly, from a high of more than 700 in 2013, to less than 50 complaints in 2017.

The Department additionally sent letters in August 2013 to 117 financial institutions, as well as NACHA, the association that administers the Automated Clearing House ("ACH") network through which bank account credit and debit card payments are sent and received. The letters requested that these institutions work with the Department to enforce existing rules and create a new set of model safeguards and procedures to stop illegal payday lending in New York. Several financial institutions responded to the Department, noting that they did not serve as originating depository financial institutions for any of the identified payday lenders, and others took further actions to block identified payday lenders or place them on denial lists used to screen transactions. Some institutions also noted that they reached out to third-party senders to confirm that they did not have payday lenders in the senders' portfolios, while another offered consumers counseling and information about alternatives to payday lenders.

To help banks identify and stop illegal, online payday lending in New York, the Department developed a database of companies that have been subject to actions by the Department based on evidence of illegal payday lending. Several banks agreed to use the information in the database, among other things, to help confirm that their merchant customers are not using their accounts to make or collect on illegal payday loans to New York consumers, to identify payday lenders that engage in potentially illegal payday loan transactions with their New York consumer account holders and, when appropriate, to contact the lenders' banks to notify them that the transactions may be illegal. The Department updates the database of payday lenders as appropriate.

In addition to these actions directed at the payment systems used by payday lenders, the Department also has used its enforcement powers to stop high-interest lenders and companies that facilitate such predatory lending. In 2015 and 2016, for example, the Department reached settlements with two payday loan lead generators, companies that advertise payday loans online and subsequently collect and sell consumer personal information to payday lenders and other online entities for a fee. The companies sell pieces of consumer information, often to the highest online bidder, which in some cases may not even be a payday lender, but instead a company that collects and aggregates "leads" or consumer information, and in turn re-package and profit from consumer data. Further, in 2015 and 2016, the Department investigated pension lending companies that, among other activity, failed to disclose high interest rates to New York consumers and made loans with interest rates above New York usury limits. In 2016 and 2017, the Department announced settlements with three debt buyers that improperly purchased and collected on illegal payday loans made to New York consumers.

The Department also uncovered internet schemes to prey on pensioners. The Department discovered that some companies solicit pensioners over the internet, seeking those who will transfer payment of their pensions for a period of time in exchange for lump sum payments. In August 2015, for example, the Department and the federal Consumer Financial Protection Bureau ("CFPB") jointly sued two pension lending companies, Pension Income, LLC, and Pension Funding, LLC in the Central District of California. The suit alleged violations of the Dodd-Frank Consumer Financial Protection Act and New York Banking and Financial Services Laws, for misleading consumers by deceptively marketing the transactions as sales instead of loans, failing to disclose high interest rates and fees, and charging interest rates that violate New York usury laws. The CFPB and the Department sought to end the illegal practices and prevent further consumer injury and to install a court-appointed receiver to facilitate the winding down of the companies and provide consumer relief through the receivership estate. In February 2016, the parties entered into a final consent judgment pursuant to which the receiver continues to administer the receivership estate and work towards winding down the businesses. The Court entered a default judgment against the remaining individual defendant in July 2016, barring him from activities involving financial products and services in New York State and ordering disgorgement.

In October 2016, the Department entered into a consent order with another pension lender, Future Income Payments, LLC ("FIP"), formerly known as Pensions, Annuities & Settlements, LLC, and its owner, pursuant to which FIP paid a fine of $500,000 and ceased doing business in New York State. An investigation by the Department found that FIP had deceptively represented that its transactions were sales of assets, rather than loans, and that FIP had loaned and transmitted money without the required licenses. The investigation found that the company violated Financial

Services Law prohibitions against misrepresentation by calling interest charges discounts and failing to disclose annual percentage rates to pensioners. FIP also violated New York's usury laws as some pensioners were charged annual interest rates of more than 130%, much greater than New York's interest rate caps. FIP agreed to revise the total amount owed by New York pensioners to the actual value of the lump sum they were lent and to forgive amounts over that amount. The settlement with FIP obtained more than $6.3 million in loan forgiveness for New York pensioners, and FIP refunded pensioners who paid more than the lump sums they originally borrowed or who paid late fees or insufficient fund fees.

In addition, in March 2015, the Department entered into a consent order with Selling Source, LLC, MoneyMutual LLC, affiliated entities, and MoneyMutual's spokesperson, Montel Williams, to resolve misrepresentations relating to Selling Source's payday loan lead generation business. Selling Source and its affiliates had collected and sold to their network of at least 60 payday lenders more than 800,000 New York consumer leads. The typical annual percentage rate range for the loans that MoneyMutual advertised was "somewhere between 261% and 1304%"—16-to-82 times higher than the legal limit in New York. MoneyMutual's advertisements failed to adequately warn consumers that the interest rates, charges, and repayment schedules offered by its network of "trusted lenders" often prevented consumers from being able to repay those loans on a timely basis, and caused them to roll over or take out additional loans to pay off prior loans. Selling Source paid a $2.1 million civil penalty and stopped marketing payday loans to New York consumers, and Mr. Williams withdrew his endorsement for payday loans in New York.

In March 2016, the Department entered into a consent order with Blue Global LLC and its CEO, Chris K. Kay, to resolve Blue Global's marketing of illegal, online payday loans to New York consumers and its misrepresentations that it provided top security for consumer personal information submitted through numerous Blue Global websites. Blue Global had collected and shared more than 350,000 applications from New York consumers with payday lenders, online data aggregators, and other third parties, and sold more than 177,000 New York consumer leads. The Department's investigation revealed that Blue Global knew the lenders to whom it connected New York consumers charged annual percentage rates of more than 500%. The company encouraged consumers to apply for payday loans with repeated assurances about its protocols for maintaining the security of consumer personal information, when in fact it did not protect consumers' information when sharing it with third parties. Under the consent order, Blue Global paid a $1 million penalty to the State, stopped marketing payday loans to New York consumers, and agreed to implement data security measures for future collection of consumer personal information should it do any lawful business in New York in the future.

In May 2016, the Department entered into a consent order with two debt buyers that improperly purchased and collected on illegal payday loans made to New York consumers. The Department's investigation uncovered that National Credit Adjusters, LLC ("NCA") had attempted to collect on 7,325 payday loan debts of New York State consumers and collected payments on 4,792 of those debts between 2007 and 2014. The Department's investigation also found that NCA had engaged in unlawful debt collection practices when NCA sought to collect on illegal payday loan debts of New York consumers. NCA repeatedly called consumers at home and at work, threatened to call consumers' employers, and called their family members to pressure them to pay the payday loan debts. Pursuant to the consent order, NCA discharged more than $2.26 million in New York consumer payday loan debts, provided refunds totaling $724,577 to more than 3,000 New Yorkers, and paid a $200,000 penalty. The Department also found that debt buyer Webcollex LLC (doing business as CKS) had attempted to collect on hundreds of payday loan debts of New Yorkers and did collect payments from 52 New York consumers. Under the consent order with CKS, CKS issued $66,129 in refunds to the 52 New York consumers affected by its unlawful practices, discharged $52,941 in debt to 106 New Yorkers, and paid a $25,000 penalty.

In September 2017, the Department entered into a consent order with another payday loan debt collector, Total Account Recovery ("TAR") and E-Finance Call Center Support ("E-Finance"), a payday loan servicer. The Department's investigation uncovered that TAR attempted to collect on more than 20,000 payday loan debts of New York consumers and successfully collected payments on over 2,000 of those debts. E-Finance made intentional misrepresentations when it attempted to negotiate payments with New York consumers and collect payments on illegal payday loan debt from New Yorkers. TAR and E-Finance repeatedly called consumers at home and at work in attempts to collect on usurious payday loans, in violation of federal and state debt collection practices laws. Pursuant to the consent order, TAR and E-Finance, which have both ceased to operate, discharged over $11.8 million in New York consumers' payday loan debts, and paid a $45,000 penalty.

(E) Consumer Litigation Financing

The Department also notes the growth of consumer litigation financing. The Department has become aware that certain companies provide cash advances to plaintiffs, either pre- or post-litigation, which are meant to fund plaintiffs' living or medical expenses while they await proceeds from a settlement or judgment. Litigation financing companies generally receive a share of the claim proceeds if the plaintiff receives payment, but the financing companies are not involved in the prosecution or resolution of the claim. The Department is concerned about the amounts that consumers are required to provide to financing companies, which can be a significant portion of the total recoveries from their lawsuits that would be usurious if lending rules were to apply. The Department also is concerned about the information many companies provide to consumers about the transactions and the manner in which they provide that information. The Department believes these issues require further study and believes legislation could provide important safeguards for consumers that do not currently exist.

SURVEY RESULTS[26]

(A) Customer and Loan Numbers

The 35 companies that provided information in response to the Department's Survey reported that in 2017, the total number of New York customers, both individuals and businesses, was 235,320, grown approximately 79% from their 2015 level; the total number of their loans to New York customers was 352,171, grown approximately 118% from their 2015 level; and the total dollar amount of all loans to New York customers was $2,981,118,348, grown approximately 42% from

[26] The Department is providing the Survey results based on the responses received from those who responded to the Survey. However, the Department has not independently verified those responses.

their 2015 level. These growth rates reflect several influences, including an increased level of activity by the existing participants, new participants that commenced activity in 2016 and 2017, and the fact that some of the respondents provided data only for 2017 and not for 2015 or 2016.

Only 33 of the respondents reported online lending in New York in 2016. For 2016, the total number of New York customers of the 33 respondents was 145,948; the total number of their loans to New York customers was 200,112; and the total dollar amount of all loans to New York customers was $2,206,429,509.

Only 31 of the respondents reported online lending in New York in 2015. For 2015, the total number of New York customers of the 31 respondents was 131,411; the total number of their loans to New York customers was 161,340; and the total dollar amount of all loans to New York customers was $2,099,853,955.

In 2017, 10 respondents collectively made the highest dollar amounts of loans, representing approximately 88% of the total dollar amount of loans offered by the 35 respondents in 2017 (approximately $2.6 billion out of approximately $3.0 billion in total), to approximately 90% of New York customers (212,147 customers out of the total 235,320 customers) served by the 35 respondents.

In 2017, the total number of New York customers of the respondents was 235,320, out of which 8,664 were New York business customers, and 226,656 were New York individual customers.[27] The total number of all New York loans was 352,171 out of which 32,627 were loans to businesses in the total dollar amount of $493,339,136; and 319,544 were loans to individuals in the total dollar amount of $2,487,779,212.

Notably, this data demonstrates that there were far more New York individual customers provided loans by the survey respondents in 2017 than business customers. Also, New York individuals appear to account for a higher total dollar amount of loans than New York businesses. The chart below reflects this disparity, with data also for 2015 and 2016, as reported by the survey respondents.

[27] For 2017, 16 of the respondents reported lending to individuals for personal, investment or family purposes; 9 of the respondents reported lending to individuals for business or commercial purposes; 5 respondents reported lending to both; 20 of the respondents reported lending to New York businesses; and 5 respondents reported lending to both. Significantly, only 12 of the respondents reported lending to individuals and/or businesses that were unbanked or underbanked.

Total NY Customers, NY Loan Amounts, and Total Principal Amounts By Year and by Customer Type				
2015-2017	Individuals/ Businesses	Individuals	Businesses	Unbanked/[28] Underbanked
2017				
Total				
# Customers	235,320	226,656	8,664	78,611
# loans	352,171	319,544	32,627	125,787
$ Amount	$2,981,118,348	$2,487,779,212	$493,339,136	$679,670,122
2016				
Total				
# Customers	145,948	138,219	7,729	73,073
# loans	200,112	180,397	19,715	95,725
$ Amount	$2,206,429,509	$1,771,353,696	$435,075,813	$607,158,826
2015				
# Customers	131,411	125,569	5,842	72,223
# loans	161,340	146,743	14,597	81,817
$ Amount	$2,099,853,955	$1,753,386,176	$346,467,780	$554, 902,941

(B) Duration of Loans

The Survey contained various questions relating to duration of loans. The response rate to the various questions ranged from 8 to 19 respondents, as outlined below. This low response rate is concerning, and therefore makes it difficult to draw conclusions about the New York market.

In 2017, duration of loans to individuals for personal, investment or family purposes ranged from 1 month to 240 months. The average duration (based on responses from 15 respondents) was 51.7 months, with a median of 41.6 months (based on responses from 14 respondents).[29] [30]

In 2017, duration of loans to individuals for business or commercial purposes ranged from 3 months to 60 months. The average duration was 27.8 months, with a median of 26.3 months (based on responses from 8 respondents).

[28] The numbers and percentages listed for the unbanked and underbanked are not separate numbers. They are included in the total numbers listed. For purposes of the Survey, "unbanked" was defined to mean an individual or business that does not have access to, or use of the financial services or products offered by regulated banking organizations, and the term "underbanked" was defined to mean an individual or business that does not have sufficient access to, or use of, mainstream financial services and products offered by regulated banking organizations. However, based on the responses received, it appears that the respondents may have used their own criteria for defining or delineating the terms unbanked or unbanked.

[29] The average statistics are unweighted calculations of the respondent reported average and median duration of their New York loans.

[30] Among the participants disclosing loan duration and disclosing the purposes of those loans, a number of participants reported offering student loans with average durations of up to 7 to 10 years, elevating the overall survey average and median duration of loans.

For loans to businesses, the average duration was 26.6 months, with a median of 25.7 months (based on responses from 19 respondents).

Based on responses from 10 respondents, for loans to individuals or businesses that were unbanked or underbanked, the average duration was 21.7 months, with a median of 19.3 months.

The reported average and median loan durations were the longest for New York loans to individuals for personal, investment, or family purposes, followed by New York loans to individuals for business and commercial purposes and to businesses which were substantially similar to each other. Reported average and median loan durations were significantly shorter for New York loans to individuals and businesses that were unbanked or underbanked. As noted, the data on duration of loans was not provided by most of the respondents. In addition, more information would be required from the respondents that did provide information to better understand the underlying reasons for such difference.

(C) Loan Sizes

Based on responses from 16 respondents, in 2017, the average[31] New York loan amount to individuals for personal, family, or investment purposes was $17,979, with a median of $12,474; and, based on responses from 9 respondents, the average New York loan amount to individuals for business or commercial purposes was $20,800, with a median of $15,567.

Based on responses from 20 respondents, the average New York loan amount to businesses was $153,662, with a median of $51,313.

Based on responses from 11 respondents, the average New York loan amount to individuals or businesses that were unbanked or underbanked was $31,349, with a median of $10,735.

The average loan amounts were the largest for New York loans to businesses, followed by New York loans to individuals and businesses that were unbanked or underbanked, then by individuals for business and commercial purposes, and by the lowest average New York loan amounts to individuals for personal, investment, or family purposes. The order for the median loan amounts were again highest for New York loans to businesses, followed by individuals for business and commercial purposes, and then by individuals for personal, investment, or family purposes. In this case, the lowest median loan amounts were to individuals and businesses that the respondents said were unbanked or underbanked.

(D) APR Numbers

The chart below sets forth the rates respondents reported for the most commonly offered loans in 2017 across customer groups, based on the number of responses received for each category of loan, as specified in the chart.

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[31] The average and median statistics are unweighted calculations of the respondent reported average New York loan amounts.

Response rates varied especially for participants reporting on New York loans to businesses. Of the respondents extending loans to businesses, the highest average of the respondent reported average median APR[32] was 25.9%, followed by loans to individuals for business or commercial purposes at an average median APR of 22.2%; loans to the unbanked or underbanked customers were at an average median APR of 19.6%; and loans to individuals for personal, investment, or family purposes at an average median APR of 14.8%. The medians of the respondent reported median APR followed the same order except that loans by respondents as made to unbanked or underbanked customers were the second highest followed by loans to individuals for business or commercial purposes. Overall this suggests that the highest APRs were among loans to businesses and to individuals for business or commercial purposes with loans to both business and individuals who were claimed to be unbanked or underbanked close behind, with the median maximum values of 61.8%, 62.3%, and 34.3%, respectively, as compared to a much lower maximum value for loans to individuals for personal, investment, or family purposes at 25.0%. Because unbanked or underbanked customers are a mix of all individuals and business customers, it is expected that the average and median values of the reported median APRs would hover between the highest and lowest values.

With respect to the high maximum values, the high interest rates have been at times explained by online lenders as necessary to cover the higher risks associated with certain consumer and small business lending. Additional information is required to evaluate what proportion of high APRs are driven by risk or by a high demand for such online loans on the part of consumers or sole proprietors and small businesses, which may not meet traditional banking credit requirements. In either case, the regulatory concern is that high APR levels have an adverse impact on consumers and small businesses, and therefore do not constitute appropriate access to credit. It is important to note in this regard that some of the maximum values reported for APRs exceed the New York criminal usury rate limit of 25%.

Median APR Numbers

	Individuals for personal, investment or family purposes	Individuals for business or commercial purposes	Businesses	Individuals or businesses that are unbanked, or underbanked
Average	14.8%	22.2%	25.9%	19.6%
Median	15.7%	16.3%	18.5%	18.0%
Minimum Value	4.3%	10.0%	8.2%	11.5%
Maximum value	25.0%	62.3%	61.8%	34.3%
Response Rate (Number of Respondents)	16	8	16	7

[32] "APR" stands for annual percentage rate of a loan, which is the total cost of borrowing money for one year, expressed as a percentage of the total amount owed.

Respondents were also asked to provide data about APR ranges across customer groups. Below is the data received from a range of 7 to 15 respondents for 2017.

Based on responses from 15 respondents, with respect to loans to individuals for personal, investment or family purposes 15.4% of their loans were in the 5% or less APR range; 30.8% of their loans were in the 5% to 10% APR range; 33.3% of the loans were in the 10% to 16% APR range; 12.8% of these loans were in the 16% to 25% APR range; and 7.7 % of the loans were greater than 25% APR.

Based on responses from 7 respondents, with respect to loans to individuals for business or commercial purposes, 5.9% of the loans were in the 5% or less range; 17.6% of the loans were in the 5% to 10% range; 35.3% of the loans were in the 10% to 16% range; 17.6% of the loans were in the 16% to 25% range; and 23.5% of the loans were greater than 25%.

Based on responses from 15 respondents, with respect to loans to businesses 6.3% of the loans were in the 5% or less range; 21.9% of the loans were in the 5% to 10% range; 25.0% of the loans were in the 10% to 16% range; 25.0% of the loans were in the 16% to 25% range; and 21.9% of the loans were greater than 25%.

Based on responses from 8 respondents, with respect to loans to individuals or businesses that were unbanked or underbanked, 14.3% of the loans were in the 5% or less range; 23.8% of the loans were in the 5% to 10% range; 28.6% of the loans were in the 10% to 16% range; 23.8% of the loans were in the 16% to 25% range; and 9.5% of the loans were greater than 25%.

(E) Fees, Costs, Expenses, and Other Charges

Based on responses from 29 respondents, lenders appear to charge a variety of fees, such as origination fees, closing fees, processing fees, maintenance fees, transactional fees, and penalty fees. Some lenders have reported a no fee policy. It is unclear from the responses received whether these fees and charges were included in the calculation of APRs. The most frequent fee mentioned by 20 respondents in 2017 was origination fees ranging from 0.9% to 6.0%.

(F) New York Loan Delinquency Numbers (past due 30 days or more)

The respondents' account of delinquent loans yielded the lowest and most inconsistent response rates throughout the Survey, and many responses were not in alignment with data reported in other sections of the Survey. Also, responses were based on each respondent's own understanding of the term "outstanding loans," and their own practices relating to charge offs. Therefore, the data reported below remains subject to these limitations, which makes drawing any meaningful conclusions from them very challenging.

The total number of delinquent New York loans (both to individuals and businesses) as of the end of 2017, was 18,725 (based on responses from 23 respondents), which represents an average of approximately 11% of the total number of New York loans outstanding as of the end of 2017 (based on responses from 22 respondents).

The total number and principal dollar amounts of delinquent New York loans to individuals for personal, investment and family purposes as of the end of 2017 (based on responses from 10 respondents), was 11,486 and $1,476,887,388, respectively, and the average principal amount of delinquent loans was $11,807, and average APR for these delinquent loans was 17.4%, with an average duration of 50.7 months (based on responses from 11 respondents).[33]

The total number and principal dollar amounts of delinquent New York loans to individuals for business or commercial purposes as of the end of 2017 (based on responses from 7 respondents), was 360 and $1,789,945, respectively (based on responses from 5 respondents), and the average principal amount of delinquent loans was $12,669 (based on responses from 6 respondents), and the average APR was 18.8% (based on responses from 4 respondents), with an average duration of 31.7 months (based on responses from 6 respondents). As noted, there were few respondents that provided answers in this category.

The total number and principal dollar amounts of delinquent New York loans to businesses as of the end of 2017 (based on responses from 10 respondents), was 2,442 and $15,051,983, respectively, and the average principal amount of delinquent loans was $34,942 (based on responses from 9 respondents), and the average APR was 37.1% (based on responses from 6 respondents), with an average duration of 14.0 months (based on responses from 10 respondents).

Again, few respondents provided data on the number of loans provided to unbanked or underbanked New Yorkers. The total number and principal dollar amounts of delinquent New York loans to individuals and businesses that were unbanked or underbanked as of the end of 2017 (based on responses from 7 respondents), was 5,330, and (based on responses from 8 respondents) $35,634,487, respectively, and the average of the respondent reported average principal amount of delinquent loans was $26,238 (based on responses from 7 respondents), with an average APR of 20.0% (based on responses from 5 respondents), and the average duration of 31.7 months (based on responses from 6 respondents).

Respondents deemed a loan delinquent from one day late at most institutions up to 15 days late. For the purposes of calculating charge offs, lenders deemed loans delinquent from one day late to 15 days late, and in some instances, charge offs were accelerated under certain circumstances, such as declared bankruptcy or if there was a particular maximum date specified ranging from 60 days or less to 120 days or more. Also, some respondents charged off delinquencies mid-year.

(G) Business Models

The number of respondents who responded to the questions relating to business models varied from 2 to 12, and not all respondents responded to every question. The Department needed responses to every question relating to business models in order to fully report on the range of business models that are being used. However, given the limited responses, a full and accurate description of all existing business models is not feasible.

[33] The average statistics are unweighted calculations of the respondent reported average principal amount of delinquent New York loans, average APR numbers, and average duration of such loans.

Based on the information submitted by the limited number of companies that responded to this question:

The total number and principal dollar amounts of all New York loans to individuals that were originated solely by the respondents in 2017 were 33,146 and $1,451,757,123, respectively.

The total number and principal dollar amounts of all New York loans to businesses that were originated solely by the respondents in 2017 were 3,047 and $77,734,382, respectively.

The total number and principal dollar amounts of all New York loans to individuals originated in collaboration or partnership with other financial institutions in 2017 were 207,776 and $1,018,070,622, respectively, and the average percentage of such loans held on the balance sheets of such financial institutions during 2017 was approximately 91%, but with an average duration of such loans on the balance sheet of 3.1 days ranging from 2 to 4 days and a median of 3.5 days.[34]

The total number and principal dollar amounts of all New York loans to businesses originated in collaboration or partnership with other financial institutions in 2017 were 29,249 and $217,156,441, respectively, and the average percentage of such loans held on the balance sheets of such financial institutions during 2017 was approximately 100%, but with an average duration of balance sheet presence of 2.8 days ranging from 1 day to 5 days and a median of 2.5 days.

The total number and principal dollar amounts of all New York loans to individuals, whether originated in collaboration or partnership with other financial institutions or not, sold, transferred, participated or assigned to third parties were 163,701 and $1,461,225,495, respectively, and as an average percentage of all outstanding loans to individuals in 2017 was approximately 61%.

The total number and principal amounts of all New York loans to businesses, whether originated in collaboration or partnership with other financial institutions or not, sold, transferred, participated or assigned to third parties in 2017 were 18,527, and $275,986,924 respectively, and as an average percentage of all outstanding New York loans to businesses in 2017 was approximately 57%.

Marketplace lenders rely on capital markets funding in order to be able to make loans. They lack the assets and resources to be able to hold loans on their own balance sheets, and thus their business model requires them to sell to other investors or institutions over 60% of their loans to individuals and over 55% of their small business loans. Many of these companies are extremely dependent on continually raising new rounds of venture capital to fund their growth, as well as to make up for their losses.

As we saw in the recent financial crisis, capital markets funding quickly disappears when markets turn down and the economy is shrinking rather than growing. Even the largest highly-rated and

[34] When loans are held on the lender's balance sheet, standards of underwriting align with the desired risk position of the overall loan portfolio. Therefore the practice of not retaining loans on the balance sheet can lead to lower underwriting standards. In addition, a significant regulatory concern is that the strategy of online lenders underwriting loans originated by banks could be motivated by attempts to circumvent state law on usury rates. This practice in general may be producing a much riskier consumer credit scenario, somewhat invisible in a strong economy but could lead to increased consumer financial instability in a downturn, as pointed out in *Opportunities and Challenges in Online Marketplace Lending* by the U.S. Department of Treasury.

well-funded non-depository lenders were immediately impacted by the withdrawal of funds by capital markets investors once the recession started. Only deposit-based lending is there to fund loans throughout the economic cycle because government-backed insurance makes those bank and credit union accounts safer in a crisis. The appetite for funding speculative lending via untested models and quick-reacting algorithms is likely to disappear even faster.

A second lesson of the recent crisis, discussed above, is that the originate-to-sell lending model may carry hidden risks for the outside investors and funders who essentially buy on trust and backward-looking credit rating models. Successful earlier experience with subprime mortgage loans was not a good guide to future performance. As the appetite of investors increased, the lending standards changed in ways invisible from the outside. Again, the lending was led by non-depository institutions without the assets or interest in holding those increasingly speculative loans to maturity. No safety and soundness regulation set limits or scrutinized procedures, such as the detailed examination and supervision of community banks that state banking regulators perform. The result was that capital-markets-funded lenders spread the contagion of speculative and unsustainable lending far and wide, crashing the U.S. and the global economy.

(H) Marketing and Advertising

Respondents to this set of questions indicated no major differences in approach to marketing or advertising to the various customer groups. All respondents use their websites for marketing. A number of respondents reported using online marketing methods, including web banners, e-mail marketing, search engine advertising, and social media advertising. Other marketing methods involve more traditional methods, such as direct mail, physical displays, and radio and television advertising.

Roughly two-thirds of the 33 respondents offering information about their marketing indicated that they either partnered with other institutions in their marketing efforts or outsourced their marketing to them. Among these respondents, a few discussed how content was approved. Some said they retained sole responsibility; others indicated that both parties would review and approve content.

Notably, only four respondents discussed disclosure of rates, terms and/or loan size and pricing despite the fact that consumer disclosure is a critical requirement under state law. Of these four, two respondents explicitly noted making disclosures in marketing materials or on their website about rates, terms, and minimum loan size. Two others indicated that their disclosures about rates, terms, loan size, and other information would occur at the contract stage.

(I) Credit Assessment/Underwriting

As noted earlier, in its examination of banks and licensed lenders, the Department focuses on underwriting standards and loan review processes of the institutions. The Department received responses from 16 respondents relating to the Survey questions regarding credit assessment and underwriting methodology for loans to individuals. It appears that the respondents use internal models, outsourced models, or a combination of the two. All models require information from the applicant and incorporate third party data. The external sources, which may vary among the companies, could include FICO Score Card, Credit bureau data, Lexis Nexis, Dun & Bradstreet, CoreLogic and ID Analytics, and social media.

The Department received 16 responses to the questions relating to credit assessment and underwriting methodology for loans to businesses. Based on the responses received, the respondents use internal models with various inputs provided by the applicant such as employment history, business history, bank statements and tax records or through external sources, such as credit bureau data or Dun & Bradstreet. A risk score is calculated based on output from the model used and assigned a credit score and the credit score will indicate whether the borrower qualifies for a loan and at what rate. A few of the respondents specified that if the model calculates a rate above 25%, they will not lend to the New York applicant.

Five respondents responded to the questions regarding credit assessment and underwriting for loans to the unbanked and underbanked. These respondents stated that the methodology for the unbanked and underbanked applicants is not different from the one for banked applicants.

The Department received a variety of responses from those who responded to the question regarding their methodology for calculating loan loss reserves. Some responded with non-numerically specific responses that consisted of various permutations of assessment of credit risk as quantified by internal or external models, and asset quality data; other responses included grouping of loans into tiers with assigned values to each tier, assigning a flat percentage or an amount deemed necessary by external auditors, or not maintaining a reserve as they may not be a balance sheet lender.

(J) Complaints and Investigations

For 2017, 20 of the 35 respondents (approximately 57% of the respondents) reported complaints within a range of 1 to 533 complaints.

Qualitatively, respondents reported that complaints related to the application process and disqualification of applicants, or the inability to obtain financing when it was sought. Other grounds for complaint included customer service, authorization or lack thereof to retrieve credit reports, reduced credit lines, and matters relating to servicing and fees. Respondents did not differentiate the complaints between the banked customers and those that were unbanked or underbanked.

COMMENTS FROM OTHER STAKEHOLDERS

The Department received 12 additional comments from a variety of stakeholders.[35] These may be summarized as follows:

1. *Level Playing Field.* A number of commenters asserted that there should be a level playing field for all lenders and that they should be regulated under the same standards, whether done

[35] The Department has received comment letters or other communications from technology and lending associations, chambers of commerce, business associations, and banking, mortgage and credit union associations.

online, over the phone, in-person, or any other way. One commenter asserted that many online borrowers do not understand the exact cost of the loan to them is that it is not just the interest rate but also the fees charged and the timing of repayments as, very often, in order to pay off one loan, the borrower would have to borrow again and ultimately the perpetual cost to the borrower can reach 100% annually.

Other commenters asserted that regulated financial institutions have disclosure obligations while unregulated online lenders do not always provide truth in lending type disclosures to their borrowers, which would include the true cost of the loan as reflected in the annual percentage rate. They also stated that, unlike community-based regulated financial institutions that have ties to their communities, online lenders do not have any stakes in New York's communities and the loans are often short-term and sometimes at interest rates without concern for the ultimate consequences to the consumer. They also argue that a number of online lenders have experienced liquidity and earnings issues, which support the need for regulation to ensure their safety and soundness. In sum, these commenters argue that online lenders should be governed by a regulatory framework equivalent to insured depository institutions and that licensure enables the Department to implement an appropriate regulatory framework to protect consumers and to provide a level playing field for regulated banks and credit unions.

2. *Access to Credit.* A number of commenters claimed that online lending is expanding access to credit by providing loans to borrowers who might not have obtained loans from traditional banking organizations. In particular, commenters representing small businesses said that a large number of small business loans are denied by traditional banking organizations, or that to bank consolidations, branch closures and other economic factors have created a credit gap making it necessary to have access to a wide range of financing options to meet the varied use cases of small businesses. They also asserted that there are benefits of online lending to microbusinesses as well as businesses in economically disadvantaged communities. Furthermore, they commented that consideration should be given to the significant differences between consumer and commercial markets. Likewise, comments from a provider of small business financing emphasized that restricting access to capital for small businesses could hurt the economy and that any regulation of small business financing should take into account the full range of products available.

   One commenter referenced research conducted by the Federal Reserve Bank of Philadelphia, using publicly available data from one of the established and geographically diverse online lenders, that indicated that the online lender has penetrated underserved communities.[36]

   Another commenter stated that digital underwriting offers choice, reduced costs, cleaner data and expanded access to credit for borrowers, particularly those who live in underserved communities. However, this commenter stated that regulation of online lenders is a key

[36] In the aforementioned study, the authors also cautioned against generalizations based on their study of one large online lender. Other studies have shown that the refinancing of existing debt is the predominant purpose of online loans casting doubt on the assumption that online lending has expanded new credit to underserved markets. In addition, consumers could be harmed if online refinancing leads to an increase in the overall debt burden to consumers through extended duration and high fees.

component of customer advocacy and that any loophole that circumvents regulation by the state to evade rules should be closed.

3. *Regulatory Arbitrage.* One commenter commented that online lending should not develop into a way of avoiding traditional banking requirements and specifically referenced the fintech whitepaper of the Office of the Comptroller of the Currency (the "OCC") in where the OCC stated that "to approve a fintech charter the agency may need to account for differences in business models and the applicability of certain laws. For example, a Fintech company with a Special Purpose national charter that does not take deposits, and therefore is not insured by the Federal Deposit Insurance Corporation would not be subject to laws that apply only to insured depository institutions."[37] The commenter states that the OCC would not be helping consumers or the banking industry if it uses its chartering power to aid entities seeking to circumvent important banking laws, and that a reckless approach to chartering would encourage entities such as payday lenders, which have traditionally been regulated at the state level, to circumvent state law by becoming Special Purpose Fintech entities. The commenter also advocates in favor of New York's authority to regulate loan servicing to impose the same consumer protection laws on online lenders as those applicable to regulated banks and credit unions.

ANALYSIS

New York has experienced a significant growth in online lending during the last several years. Advances in technology and the use of big data have started to change the way some consumers and small businesses gain access to financing. The Department supports innovation and notes that new channels of delivery can play an important role in facilitating access to capital by New York consumers and small businesses. At the same time, the Department must ensure that such innovation is responsible and that alternative lending models do not cause consumer harm, create safety and soundness risks for lending institutions, or create systemic risk in our markets.

Based on the results of the Survey, comments received, and the Department's experience and research, the Department provides the following summary of the benefits and risks associated with the lending activities and practices of online lenders:

1. *Access to Credit from New York State Regulated Institutions*. New York State chartered and licensed depository and non-depository financial institutions, including New York State chartered banks and credit unions, and New York State licensed lenders and sales finance companies, have been and continue to be a significant source of credit for New York consumers and small businesses.

   Adding up the loan volumes from New York State chartered banks and credit unions, and New York State licensed licensed lenders and sales finance companies, the data reveals that their lending levels to individuals and small businesses exceeded $51 billion in 2017 (which does

[37] The Department and the Conference of State Bank Supervisors have challenged the authority of the OCC to issue a special purpose bank charter for financial technology firms as an unlawful assertion of power that would seek to usurp state laws, including usury and state consumer protection laws.

not include residential or commercial mortgage lending to such borrowers, or lending from federally-chartered banks and credit unions). By contrast, the 35 non-bank respondents who responded to the Survey for 2017 reported the total amount of $2,981,118,347 in loans to New York customers in 2017– just below 6% of the credit provided by New York State-chartered and New York State-licensed institutions.

<u>Total Lending by New York State Chartered and Licensed Institutions</u>

Loan volumes ($000's)	2017	2016	2015	Number of institutions
NYS chartered Community Banks - Bank Loans to individuals	$15,205,667	$11,412,790	$9,396,166	82
NYS chartered Community Banks - Bank Credit Card loans	$486,806	$430,639	$414,903	82
NYS chartered Community Banks - Bank Auto loans	$5,009,254	$4,242,563	$3,723,309	82
NYS chartered Community Banks - Bank Loans to Small Business	$14,119,343	$13,435,869	$13,193,354	82
NYS chartered Credit Unions	$52,263	$48,413	$44,662	15
NYS licensed Licensed Lenders	$1,063,280	$1,010,975	$941,649	17
NYS licensed Sales Finance Companies	$15,872,148	$16,846,079	$17,469,372	94
Total lending by NYS chartered & licensed - to Individuals & Small Business	$51,808,761	$47,427,328	$40,518,457	216

2. *Credit Access*. Access to credit is essential to the well-being of consumers, the lifeblood of small businesses and for economic growth, job creation and prosperity of our communities in New York. The ability of individuals to purchase goods and services and meet their basic needs, including the ability to buy or rent a car, a large appliance, or start a small business, is

the foundation of our economy. Without access to credit, individuals may not be able to meet their basic day-to-day needs and businesses may not be able to grow and create new jobs, promote prosperity in their communities, or create opportunities for future generations. Therefore, it is essential that consumers and businesses have access to safe and responsible credit, which includes affordable credit.

Several commenters stated that through the use of alternative data sources, data analysis and automated underwriting models, online lenders have filled the gap left by traditional banking organizations by providing access to credit for consumers and small businesses, there are also reports to the contrary. Many of these reports rely on survey data, which may not be complete as not all lenders make their loan level data publicly available, and also are subject to biases in the sample selection and may be based on inconsistent standards of responses. As such, the results provide challenges to researchers in their ability to draw broad conclusions about the industry. In fact, the Department encountered these same problems in its Survey, as a large number of companies did not respond and large numbers of those that did respond did not fully respond to certain key questions including those relating to APRs, disclosures and delinquencies.

The timing of the reporting of data is also an important factor to consider. Rapid lending based on credit models that are developed during a generally favorable economy with a minimal track record, and funded through investors and capital markets sources that may not always be available, is not a model that assures sustained access to credit for consumers and small businesses. In fact, in today's strong economy, online lenders that rely on capital markets and investor funding for their businesses remain subject to credit and liquidity constraints during economic downturns and the borrowers who rely primarily on funding from such lenders may not be able to access credit through them during such times. Nor can the underwriting model of these lenders be relied on without stress testing, for an economic downturn, when restraints on the companies and investors may cause debt collection practices that may be of concern from a consumer protection standpoint.

However, access to credit alone is not the only factor to consider when evaluating the impact of automated lending systems that are developed by institutions that presently are largely unlicensed and unregulated. From a short-term perspective, immediate access to credit appears to be a benefit for consumers and businesses. However, from a broader perspective, lending at ultimately unaffordable rates and in unsustainable or unpayable amounts, would neither benefit consumers, small businesses, nor the lending institutions.

The Survey results demonstrate an increased level of online lending in New York since 2015 although the data suggests that the majority of the loans were extended to individuals rather than businesses. Significantly, the Survey results do not support any claim of expanded credit access for New Yorkers who are unbanked or underbanked. In fact, the survey results for 2017 demonstrate that out of the 35 respondents to the Survey, only 12 institutions reported lending to the unbanked and underbanked in New York, and others explained that their systems did not track the unbanked and underbanked status of their customers.

3. *Small Business Lending*. The Department agrees with the commenters that access to a variety of financial options is critical to the continued operations and success of small businesses in New York. The Department notes, however, that small business loans are not currently subject to the same consumer protection laws and regulations that govern consumer loans except for protections as provided under contractual arrangements, fair lending laws and the federal Equal Credit Opportunity Act. Thus, while the Department agrees that small businesses should have access to a variety of financing options for their capital and other needs, the Department believes that the individual owners of New York small businesses should benefit from the same protections as New York consumers.

   Consumer advocates argue that small business borrowers should be treated as individual consumers and that they have similar needs for safeguards as consumers, such as the need for stronger data security, and transparent and clear disclosure of the loan terms, and the true cost of their loans so they can compare prices and shop for the most suitable loan for their business needs. Many small and micro businesses are owned by few individuals with few or no employees, including "mom & pop" small businesses, and minority owned businesses. The U.S. Treasury Department Report of May 10, 2016 on "Opportunities and Challenges in Online Marketplace Lending" specifically states that "strong evidence indicates that small business loans under $100,000 share common characteristics with consumer loans yet do not enjoy the same consumer protections."

   The Department does not believe that subjecting online lenders to the same set of rules and standards as are applicable to New York State regulated financial institutions would result in the limitation of access to credit by small businesses, as responsible lenders would be willing to abide by the same set of safeguards and standards as are applicable to other regulated institutions. Even the industry itself acknowledges the need to protect small businesses as a few online lenders have developed a set of best practices, titled "Small Business Borrower's Bill of Rights."

4. *Use of Alternative Data Sources*. The alternative sources of data and scoring models that online lenders use to evaluate credit applications vary, and could include data such as utility payments, rent payment history, insurance claims, use of mobile phones, social media, sales data, or other personal data of consumers that traditional banking organizations may not typically use. While reports claim that the use of alternative sources of data may result in expanded access, a faster turn-around of credit decisions, convenience, and reduced costs, the extent of the impact on expanding credit access, particularly for the unbanked and the underbanked, or on reducing the cost of funding to borrowers, is not entirely clear. In particular, analysis is needed as to whether alternative sources of data are more prone to errors and inaccuracies and may create unfair disadvantages for consumers and lead to disparate impact and fair lending violations. Furthermore, it is essential that businesses ensure the security of the collection, use and disclosure of personal and sensitive consumer information in order to avoid the potential harm to consumers of a data breach and any privacy law violations. The Department's cybersecurity regulation is an important step forward to protect the security of consumer's data, and should be followed by all companies seeking to provide financial services to New York consumers.

5. *Loan Pricing.* While the use of automation, alternative data sources, and machine learning could potentially reduce the time and cost of making credit decisions and monitoring of such loans by online lenders, it is not clear that the benefits of such reduced costs are in fact passed on to the borrowers in the form of reduced loan costs. In fact, based on comments received, the Department's own experience, and the available data, it appears that some online lenders charge very high interest rates on their loans to borrowers. Moreover, as discussed above based on the responses received from the Survey respondents, it is not clear whether all fees and charges are included in the calculation of annual percentage rates. There also is not a uniform practice among the respondents to disclose in a clear, simple and transparent manner the full price of a loan, including all fees, charges and other costs to their borrowers either as included in the applicable annual percentage rate of the loan or in addition to the APR. Regulated banks and credit unions are required to provide borrowers with standardized and understandable information regarding their loans, including the pricing of the loans pursuant to the federal Truth in Lending Act ("TLA") and its implementing Regulation Z. While some online lenders are disclosing their loan pricing in a manner consistent with the TLA, there are others that are not doing so in a systematic way. The Department believes that greater transparency and compliance with the requirements of the TLA is necessary for the protection of consumers and achieving a level playing field with regulated banking organizations.

6. *Delinquencies.* Since the financial crisis, as a result of reforms that followed, the credit market in the U.S. has been favorable. While during such a favorable credit environment, borrowers typically pay off their loans, underwriting standards and credit assessment methodology utilized by online lenders must be able to withstand an economic downturn. As we saw in the mortgage crisis, when the economy has a downturn, an increasing level of delinquencies could follow with disastrous consequences for all involved. Additionally, as evident from various reports and from the Department's enforcement actions relating to improper collection practices, once an account is deemed uncollectible or charged off, the defaulting borrowers become subject to improper third-party collection practices. Many of these accounts are often sold or outsourced to third parties, in some cases without appropriate documentation to support the loan. This experience highlights the importance of ensuring that borrowers are protected at all stages of the debt process. Moreover, to the extent loans are sold to third party investors, whether as loans or as securitized products, delinquencies may adversely impact such investors and create systemic risk in our markets.

7. *Business Models.* A number of online lenders working in combination with federally chartered banks, or FDIC-insured banks located in jurisdictions that do not have interest rate protections on par with New York's, have expanded consumer lending through their online platforms without regard to the type of loans offered, the size of the loans or the interest rates charged. In doing so, many claim that the banking institution with which they have partnered is the "true lender" of the loan, and that, therefore, the online lender is not subject to the Department's licensing and oversight and that the loan transaction is exempt from New York usury limits and other consumer protections. The Department disagrees with this position.

   Indeed, this claim is made notwithstanding the fact that the online lender is, in many cases, the true lender. In reality, in many cases, the banking institution has little involvement in the credit origination and, typically, the online lender is the entity that is engaged in marketing, solicitation, and processing of applications, and dealing with the applicants. In addition, the online lender may be the purchaser of the loan from the banking institution in whole or in part, and at times, may also act as the servicer of the loan, and may sell the loan to investors either as loans or as securitized products.

Given their fast-paced growth and the seriousness of the impact on New York consumers and small businesses, the Department began to look into the lending practices of a number of online lenders believed to be active in New York by sending them a letter of inquiry in 2016. The responses demonstrated that, irrespective of whether the loans were made at interest rates consistent with New York law, the loans were being made in large numbers and amounts, and a number of lenders were selling the loans, or packaging them into securitized financial products and selling them to a variety of investors. Also, in many instances, the loans were being fashioned specifically to avoid licensing and oversight by the Department.

In May 2015, the U.S. Court of Appeals for the Second Circuit decided *Matter of Madden v. Midland Funding*.[38] In that case, Madden, the plaintiff, had sued Midland Funding and its subsidiary, accusing the company of using oppressive and improper debt collection practices under federal law and charging high interest rate under New York law. Midland argued that, as a national bank assignee, it was entitled to preemption of state usury laws granted to national banks under the National Bank Act. The Second Circuit held that preemption applies only where the use of state law would undermine a national bank's exercise of its power under the National Bank Act. While the assignor was a national bank, Midland and its partners are not.[39]

CONCLUSION AND RECOMMENDATIONS

The rapid growth of online lending clearly shows that there is value to new technologies that allow financial institutions to connect with consumers and small businesses in new ways and offer them products that fit their needs and drive growth in our economy. The Department appreciates and recognizes the value of innovation and welcomes automation and novel processes in enhancing credit access, particularly to New Yorkers who are unbanked or underbanked, or otherwise lack meaningful access to credit. However, the Department believes that such innovation must also be responsible. As with any innovation, all associated risks must be fully understood and managed. Responsible innovation means that consumers and small businesses that need to borrow will gain access to funding in a manner that is not harmful to them and does not subject them to predatory pricing or abusive practices. Responsible innovation also means that the lending institutions' business models and practices, including their methodology for credit assessment and underwriting, do not create undue risks in a manner that would adversely impact their safety and soundness, or create systemic risk in our markets.

[38] 786 F. 3d 246 (2d Cir. 2015).

[39] There is a pending bill titled "Modernizing Credit Opportunities Act" (H.R. 44391), which seeks to reverse the Second Circuit decision in *Madden v. Midland Funding*. The Department opposes this bill and is concerned that H.R. 4439 could result in "rent-a-bank charter" arrangements between banks and online lenders that are designed to circumvent state licensing and usury laws.

Online lending is just a delivery channel for products that have existed for many years and have been offered by a variety of financial institutions for many years. In New York, a variety of New York State chartered and licensed depository and non-depository financial institutions, including banks, credit unions, licensed lenders, sales finance companies, premium finance companies, and mortgage companies, have been offering loans to consumers and businesses for a variety of purposes and uses at rates that reflect genuine market competition that keep interest rates reasonable. New York licensing and regulation applies to the activity irrespective of the method or channel of delivery. In fact, a number of New York State chartered and licensed financial institutions use new technologies and offer loans online to consumers and small businesses.

The Department believes firmly in supporting all businesses that provide responsible financial services, on a level playing field. Accordingly, the Department recommends the following:

1. *Equal Application of Consumer Protection Laws.* New York has strong consumer protection laws and regulations that apply to financial institutions, including those relating to transparency in pricing, fair lending, fair debt collection practices, and data protection. These protections should apply equally to all consumer lending and small business lending activities. This includes robust consumer disclosures; the use of technology easily permits transparency, including disclosures of the full cost of a loan to a borrower and providing the consumer with full understanding of the long-term consequences of accepting short-term relief for a financial need.

2. *Usury Limits Must Apply to All Lending in New York.* Easy access to credit at usurious rates has long been prohibited in New York and allowing institutions to bypass this sound regulatory structure is counterproductive to sound economic development and consumer protection. A loan is a loan from a borrower's perspective, and the borrower deserves to get the benefit of New York's protections, whether the borrower borrows from a bank or credit union or from an online lender. All New York lenders should operate under the same set of rules and be subject to consistent enforcement of those rules to achieve a level playing field for all market participants, which is the underlying principle of free markets and competition.

3. *Licensing and Supervision.* New York State chartered banks, credit unions and licensed non-depositories are subject to regular examinations by the Department and, if applicable, federal agencies, that assess the overall condition of these regulated institutions from a safety and soundness perspective and proactively address concerns before an issue arises that could impact the institution, the broader market, or consumers. Currently, many online lenders remain unlicensed in New York with no direct supervisory oversight from a safety and soundness or consumer compliance perspective. Direct supervision and oversight is the only way to ensure that New York's consumers and small business owners receive the same protections irrespective of the channel of delivery, and that all lenders operate their businesses and conduct their activities in a safe and sound manner so that they may continue providing access to New Yorkers, and to prevent potential risk to our financial markets in New York.

   As discussed above, New York Banking Law Article IX requires a non-depository lender to be licensed as a Licensed Lender to engage in consumer lending if the interest rates it will charge would be higher than the 16 percent per annum and the loans in question are at or below certain dollar amounts.[40] Given the low level of national interest rates in recent years, certain online lenders have been able to offer profitable rates under New York's usury limit, such that they would not be required to be licensed and overseen by the Department. In 2017, the Department proposed legislation that would amend B.L. Section 340 to reduce the interest rate above which a non-depository lender is required to be licensed to 7 percent per annum from 16 percent per annum. The Department continues to believe that this licensing requirement would protect New York's market and consumers, and provide an even playing field for New York's financial institutions.

As New York's financial services regulator, the Department licenses and oversees a broad and diverse set of depository and non-depository financial institutions. In carrying out these responsibilities, the Department evaluates an institution's ability to operate safely and soundly and to serve borrowers responsibly and effectively. The Department promotes innovation and seeks to preserve a stable and well-regulated financial market. Enhancing the ability of the Department to license and supervise online lenders that operate in New York would benefit New York consumers and small businesses, enhance the safety and soundness of the online lenders and the New York market, level the playing field, and promote responsible innovation.

[40] *See* B.L. §§ 340, 14-a; and G.O.L. § 5-501.