2005 Market Street, Suite 2800
Philadelphia, PA 19103-7077
P 215.575.9050
F 215.575.4939

901 E Street NW, 10th Floor
Washington, DC 20004
pewtrusts.org
P 202.552.2000
F 202.552.2299

October 22, 2020

Clerk of the Commission, State Corporation Commission
c/o Document Control Center
P.O. Box 2118
Richmond, VA 23218

SUBMITTED ELECTRONICALLY

Re: Proposed Consumer Finance Regulations (BFI-2020-00055)

To Whom It May Concern:

We write to submit comments on the proposed regulations referenced above. Pew is a global, non-governmental research and public policy organization dedicated to serving the public. We strive to improve public policy by conducting rigorous analysis, linking diverse interests to pursue common cause, and focusing on tangible results. Consumer finance is an area to which Pew has dedicated significant resources for more than a decade. We have worked to fill gaps in available research about the markets for payday, auto title, installment, and similar forms of small-dollar loans, particularly with respect to understanding the needs and experiences of borrowers evaluating relevant policies. We have produced a comprehensive body of research and developed a group of experienced experts on this subject.

We commend BFI and the Commission for your efforts to establish clear and thorough regulations implementing Virginia's consumer finance and similar statutes. As participants in recent efforts to revise these statutes, we appreciate the opportunity to provide the following comments on the proposed regulations. We would welcome the chance to discuss these issues at any time.

General comments

Chapters 1215 and 1258 of the 2020 Virginia Acts of Assembly enact HB 789 and SB 421, respectively (we refer to this as the "new legislation" below). These bills, which sponsors dubbed the *Virginia Fairness in Lending Act of 2020*, enact numerous interrelated reforms to Virginia's statutes regarding open-end credit plans (§6.2-312), consumer finance companies (§6.2-1500 et seq.), short-term loans (formerly "payday lenders," §6.2-1800 et seq.), motor vehicle title loans (§6.2-2200 et seq.), and credit services businesses (§59.1-335.1 et seq.). According to the Commission's order, the Bureau of Financial Institutions (BFI) is proposing regulatory amendments that are primarily designed "to implement and clarify certain aspects

of the legislation" as it relates to Chapter 15 (consumer finance companies, §6.2-1500 et seq.) as well as "to generally update" and "augment" these provisions in certain ways. Accordingly, our present comments will focus narrowly on these aspects of the law and the proposed regulations, with particular emphasis on matters pertaining to relevant research and experience we have accumulated.

<u>10VAC5-60-15. Surety bond; other requirements for licensees; acquisitions</u>

In this section and elsewhere, the proposed regulations contemplate certain requirements with respect to a licensee's "place of business." For example, in this section, the proposal would require liquid assets of "at least $25,000 per place of business." However, the new legislation expands the types of allowable business models to include internet lending and the use of third-party access partners (for example, revised §6.2-1523.2 provides that Chapter 15 applies to internet lending and gives the Commission authority to set relevant requirements, and new §6.2-1523.1 establishes legal conditions for access partners). Wherever the Commission refers to "place of business" in its regulations, there is potential for confusion or misunderstanding about how such rules relate to internet lending or use of access partners.

Accordingly, we recommend that BFI clarify the liquidity requirements regarding what constitutes a "place of business." For reasons discussed below under 10VAC5-60-60, BFI may wish to adjust its method of calculating liquidity requirements based on total revenue generated within the Commonwealth instead of or in addition to the number of places of business the licensee maintains within the Commonwealth.

<u>10VAC5-60-25. Access partners.</u>

Section 6.2-1523.1 of the new legislation requires licensees to maintain written agreements with access partners (subsection (A)(2)) and conduct due diligence reviews and risk-based supervision of all access partners (subsection (A)(3)), among other requirements. However, the proposed regulations are silent about these requirements and establish no consistent mechanism for compliance or supervision. In the absence of such mechanism, licensees may struggle to establish effective compliance programs and BFI may be unable to identify problems or enforce the law effectively.

Accordingly, we recommend that BFI require each licensee to submit, on a routine basis, (1) a copy of all written agreements it maintains with access partners (or samples thereof), and/or require each licensee to complete a BFI-furnished questionnaire certifying that it maintains written agreements with all access partners that meet specific *requirements noted in §§6.2-1523.1(A)(1); and (2) a written report documenting the licensee's policies and activities regarding the due diligence review and risk-based supervision program required in §6.2-1523.1(A)(3). To simplify compliance and oversight with the latter requirement, BFI may wish to provide a standard form or questionnaire.*

10VAC5-60-40. Rules governing open-end credit business in licensed consumer finance offices (Repealed.)

10VAC5-60-45. Conducting other business

In general, we applaud the proposed rules governing the conduct of other businesses in Chapter 15 licensee locations, particularly the provisions found in proposed 10VAC5-60-45(F). The rules generally strike a reasonable balance among the interests of licensees, borrowers, and the public by clearly distinguishing the provision of consumer finance loans from other types of business and giving licensees incentive to help uphold the rules by making them responsible for non-compliance by persons conducting other business in connection with the licensee's operations. However, we have one key concern and one key question with the proposal as noted below.

Our key concern is about credit insurance. Proposed subsection (C) states that the "sale of insurance or enrolling borrowers under a group insurance policy by a licensee shall not constitute other business… when such insurance covers potential risks or losses associated with consumer finance loans made by the licensee." The proposed regulations would exempt the sale of credit life and similar insurance from the otherwise fair and reasonable requirements of this proposal. First, this exemption and the lack of any clarifying language about the rules that do govern credit insurance create ambiguity, especially about the prohibition of conditioning the provision of credit or its cost on the purchase of credit insurance. In our analysis, this would run contrary to relevant statutory language while also creating risk of evasion or consumer harm, whereas applying the safeguards would largely codify mainstream business practice in the Commonwealth and prevent abuses that have been identified in research. Second, we have concerns about the potential for creditors to evade established rate and fee caps by directly providing and charging for credit insurance rather than offering it as a service provided by a third party.

As proposed, the exemption for credit insurance could be interpreted to allow a licensee to charge additional insurance fees to cover its own risks, including risk of loss, associated with consumer finance loans it makes to a consumer, directly as an insurance provider and without regard to the general safeguards that apply to other business under the proposed regulations. In addition to creating a potentially harmful precedent, this would run counter to statutory provisions. Revised §6.2-1523 states that a consumer shall be charged "no further or other amount whatsoever," on top of the specified allowable interest and fees, with only three exceptions. The exception for "insurance premiums" in §6.2-1523(1) requires that any insurance premiums be "*actually paid out* by the licensee to any insurance company or agent duly authorized to do business in the Commonwealth or another state for insurance *for the protection and benefit of the borrower* written in connection with any loan" (emphasis added).

The statutory requirement that the premiums be "actually paid out" indicates that such premiums should be given to a third party not under control of the licensee and not for the

licensee's remunerative benefit.[1] And the requirement that the premiums be paid "for the protection and benefit of the borrower" disqualifies a licensee or its affiliate from offering insurance for the purpose of covering "potential risks or losses associated with consumer finance loans made by the licensee," as the proposed regulation would require, except in cases where the credit insurance is unambiguously optional for the borrower. In sum, the statutory language allows for the offering of credit insurance but not if the licensee is retaining the premiums and only where the borrower is taking out the insurance knowingly, voluntarily, and for their own protection.

Further, while it is understandable that BFI would want to accommodate the provision of credit insurance given its historical role in Virginia's consumer finance market, we note that exempting the provision of credit insurance from the proposed regulations governing the conduct of other business creates serious risk without apparent countervailing benefit or statutory mandate. Research shows that credit insurance can and sometimes is abused unless properly regulated.[2] This is especially true where the licensed lender can use credit insurance as a way of boosting loan-related revenue beyond what applicable law would otherwise allow.[3]

More fundamentally, allowing licensed lenders to provide insurance directly or indirectly through a licensed affiliate (as opposed to offering insurance provided by a third party) runs counter to the policy that the legislature set when it capped allowable interest and fees on consumer finance loans. Lenders protect against and compensate themselves for the risk of credit losses by charging interest and fees sufficient to cover their costs and generate profit. By allowing a licensee to insure its own loans (directly or via a provider under common ownership or control), BFI would be allowing lenders to double-dip and impose charges that exceed the limits set by the legislature.

Accordingly, we recommend modifying the proposed regulation to clarify two things. First, that even though a licensee may offer credit insurance, the provider of the insurance must be a separate and unaffiliated legal entity that is a duly authorized insurance provider.[4] Second, to prevent bad actors from exploiting ambiguity, we ask BFI to clearly state that consumer finance licensees may not condition the provision of credit or its cost on the purchase of insurance and that the other reasonable safeguards proposed in 10VAC5-60-45(F) apply to the provision of credit insurance—which would most easily be accomplished if BFI does not exclude the provision of credit insurance from its definition of "other business," so that the proposed general

---

[1] Va. Code Ann. § 38.2-3733 allows for a portion of an insurance premium to be given to the creditor and sets conditions by which insurance may be provided and serviced at a creditor's place of business. This establishes that a creditor may act like any other insurance agent and be paid for that. But it would not justify allowing the creditor to directly provide the insurance or receive additional compensation for insuring against credit losses, above and beyond the interest and fees that Chapter 15 of the code would allow.

[2] The Pew Charitable Trusts, "State Laws Put Installment Loan Borrowers at Risk" (October, 2018), https://www.pewtrusts.org/en/research-and-analysis/reports/2018/10/17/state-laws-put-installment-loan-borrowers-at-risk.

[3] Id. at 11-23.

[4] Nationally, we are aware of consumer finance companies that hold controlling interests in affiliated insurance providers, something that runs contrary to mainstream practice in Virginia and our recommendations.

safeguards apply. Applying the safeguards already proposed in subsection (F) of this section to the provision of credit insurance would clearly require the consumer finance licensee to comply with applicable laws (proposed subsection (F)(3)) and maintain clear records (proposed subsection (F)(5)), prohibit false or misleading advertising (proposed subsection (F)(3)), and prevent licensees from making credit or its cost provisional on the purchase of credit insurance (proposed subsection (F)(4)). Exempting credit insurance from these modest provisions is not warranted and could expose Virginia borrowers to harms experienced outside the Commonwealth. Conversely, applying these safeguards to credit insurance, which are reasonable and broadly reflect mainstream business practice, would bring substantial benefits to the marketplace by preventing certain document abuses related to the provision of credit insurance. Further, we note that while the Commonwealth's existing laws governing insurance may be robust and could offer some of the requested safeguards, they are not designed to govern creditors or consumer finance licensees and are not completely clear regarding the practices BFI has identified in its proposed regulations and that are noted above. In particular, even though one section of Virginia's insurance code (§38.2-3721) may suggest that credit insurance could be required as security of indebtedness in some circumstances, BFI and the Commission should clearly state that it is impermissible to do so for consumer finance loans.

Additionally under proposed 10VAC5-60-45, we question why the proposal would seem to expand a licensee's right to conduct the business of open-end credit in ways not contemplated by the new legislation and not justified by any articulated public policy reason. The proposed regulation would repeal existing 10VAC5-60-40(A), which specifies that "[t]he business of extending open-end credit shall be conducted by a separate legal entity, and not by the consumer finance licensee." In its place, newly proposed 10VAC5-60-45(A) specifies that the term "other business operator" refers to "a licensed consumer finance company or third party, including an affiliate or subsidiary of the licensed consumer finance company…." The proposed "additional conditions" applicable to open-end credit in proposed subsection (G) of that section, though reasonable in their own right, do not modify this definition in any way (for example, they do not incorporate the existing regulatory requirement that the business of extending open-end credit be conducted by a separate legal entity.)

Therefore, it appears that BFI is proposing to allow, for the first time and contrary to existing regulations, consumer finance licensees to own or control open-end credit businesses that operate within locations where the licensee also makes consumer finance loans. The reasons for this change are unclear, and the new legislation does not specify this change. While it is true that the new legislation (at revised §6.2-312(D)) comprehensively bans Chapter 18 and Chapter 22 licensees or affiliates from providing open-end credit but does not apply such a ban to Chapter 15 licensees, this cannot necessarily be read as legislative acceptance of Chapter 15 licensees offering open-end credit *concurrently or at the same place of business* as it provides consumer finance loans.

BFI has not explained the rationale for this regulatory change. Further, the Commission may have overlooked it (on page 4 of its order, the Commission states that "section 10VAC5-60-45

incorporates the Commission's existing regulations governing the conduct of open-end credit business" but does not acknowledge the substantial change represented by the effective repeal of the requirement that the open-end credit provider be a separate legal entity). There may be reasons for making this change, but they do not derive from legislation and they are not clear.

Therefore, while we cannot offer a recommendation as to whether or not to proceed with this change, we note that it is substantial. We encourage BFI and the Commission to reconsider the merits of the proposal to remove the legal entity requirement currently found in 10VAC5-60-40(A), and if proceeding with it, clearly explain the rationale and propose any necessary safeguards for identified risks.

<u>10VAC5-60-60. Schedule prescribing annual fees paid for examination, supervision, and regulation of consumer finance companies</u>

The proposed regulations specify a minimum fee for examination plus an "annual fee for each licensee [computed] on the basis of its total assets combined with the total assets of its affiliates conducting business in any of its authorized offices…." Presumably, total assets refers to assets associated with the licensee's Virginia operations. Otherwise, under the proposed formula the annual fee could exceed $10 million for some lenders (the largest storefront lender in this market has global assets of approximately $20 billion, and affiliates' global assets could range from several billion dollars for a company like Western Union to more than 100 billion dollars for a company like Walmart). Yet the proposal does not specify how BFI will calculate what percentage of a licensee's or affiliate's global assets would be considered to be related to its Virginia operations, either for traditional storefront lenders or for online lenders or licensees operating via access partners.

Accordingly, to ensure a level playing field and continued consumer access to credit, we recommend that BFI clarify or simplify its approach. Though we have not studied how best to assess fees to cover supervisory costs, it seems reasonable to identify an approach that achieves an equitable result among all licensees regardless of whether they operate via storefront, internet, and/or access partners, and to cap the total fee exposure of licensees in some way. Licensees with few or no physical stores should be required to pay fees commensurate with similarly sized licensees that operate via stores. While the proposal to assess fees based on total assets appears equitable on its face, it raises difficult questions about how to calculate total assets, ensure equitable treatment among all licensees, and keep fees constrained to a level that reasonably relates to the actual costs that BFI incurs to pursue its mission. We suggest that BFI consider basing the fee on total revenue generated within the Commonwealth instead, or otherwise clarifying its approach to ensuring equitable treatment among all licensees and capping total fee exposure in some way, especially in cases where affiliated companies may have much larger total assets than the licensee itself.

Again, we thank you for the opportunity to comment on this proposal and we remain available to discuss these issues at any time.

Sincerely,

Nick Bourke
Director, consumer and home financing
The Pew Charitable Trusts
nbourke@pewtrusts.org