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

SUBMITTED ELECTRONICALLY

Re: Proposed Regulations Under § 6.2-1800 *et seq.* (BFI-2020-00109)

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 and 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 small-dollar lending 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.

<u>General comments</u>

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" or "new law" 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.).

The Bureau of Financial Institutions (BFI) is proposing regulatory amendments to effect the purposes of Chapter 18 (§6.2-1800 *et seq*.) as well as "various technical changes as well as an assortment of revisions that are not prompted by the legislation." Accordingly, our present comments will focus mainly on these aspects of the law and the proposed regulations, with particular emphasis on matters pertaining to relevant research and experience we have accumulated.

10VAC5-200-20. Requirements for licensees; operating rules; acquisitions.

Under item H (bottom of page 5, top of page 6 of the proposed regulations), BFI has left in place the following prohibition: "A licensee shall not require or accept multiple checks or any additional or alternative security in connection with" a short-term loan. However, the new legislation transformed covered loans from being repayable in a single-payment to being repayable in multiple installments. More specifically, the new law revoked a prior prohibition against holding multiple checks.[1] Under the new law, there are certain risks and questions that emerge about the holding of a large check to secure a loan, and there may be reasons to allow lenders to hold more than one check. We elaborate on these points below.

Accordingly, BFI may wish to update or clarify its policies about holding checks as security, accelerating loans, and providing prompt refunds.

If licensees are permitted to hold only one check as security for the new type of installment loan, as BFI implicitly proposes, this raises the possibility that they might try to obtain from the borrower a check that exceeds the amount that would actually be due at the time the licensee attempts to cash the check. This raises several important questions about loan acceleration, collection, and refunds that the proposed regulations do not address. For example, §6.2-1816(23) states as follows (underlining emphasis ours):

> 23. A licensee shall not make a loan to a borrower that includes an acceleration clause or demand feature that permits the licensee, in the event the borrower fails to meet the repayment terms for any outstanding balance, to terminate the loan in advance of the original maturity date and to demand repayment of the entire outstanding balance, unless both of the following conditions are met: (i) not earlier than 10 days after the borrower's payment was due, the licensee provides written notice to the borrower of the termination of the loan and (ii) <u>in addition to the outstanding balance, the licensee collects only prorated interest and the fees earned up to termination of the loan</u>. For purposes of this subdivision, the outstanding balance and prorated interest and fees shall be calculated as if the borrower had voluntarily prepaid the loan in full on the date of termination.

Read in conjunction with §6.2-1818.2 ("Statement of balance due; repayments and refunds"), this subdivision establishes that it would be illegal for a licensee to cash a check held as a security for an amount that exceeds the outstanding balance plus the interest and fees *due at the time the loan was accelerated*, unless the lender issues a refund "as soon as reasonably possible and not later than two business days after receiving payment from the borrower" (§6.2-1818.2(H)). In addition to the clear compliance obligations these passages of law create with respect to collection and refunds, we think this part of the law should be read to indicate that lenders should avoid charging or collecting more than what is owed unless reasonably necessary. Furthermore, it is important to note that in general, the new law establishes a policy that disfavors large / lump-sum payments on loans and promotes protections for

[1] The following provision from the prior version of §6.2-1816 is no longer part of the law: "4. A licensee shall not require or accept more than one check from a borrower as security for any loan." See lines 653-654 of the bill.

consumers against the abuse of checks or electronic payment plans in the collection of loans.[2] On the other hand, the law remains clear that lenders may use checks to secure loans. And as noted above, the legislature recently removed the prohibition against holding multiple checks for this purpose. BFI has not addressed these issues in its proposed regulations. *This suggests that BFI should clarify a licensee's obligations with respect to collecting payments and issuing refunds; and that licensees should be allowed to hold at least two checks to secure a loan, subject to certain rules and protections*.

Further, if a check held as security were to include any amounts other than principal amount borrowed, this would create real risk that the check amount would exceed the amount owed at the time the check is cashed. This is especially true wherever the check includes interest and fees greater than an amount that would accrue during a single month / repayment period. *This suggests that BFI should prohibit licensees from holding a check for an amount that includes anything other than principal borrowed (and not interest or monthly maintenance fees). This is the policy that Colorado's administrator chose in 2010, when that state implemented reforms that are substantially similar to the ones reflected in Virginia's new law.*[3]

Another critical and related question concerns the law's requirement for a prompt refund to borrowers in the event a licensee receives more than an amount actually owed. As noted above, §6.2-1818.2(H) requires licensees to provide any refund due to a borrower "as soon as reasonably possible and not later than two business days after receiving payment from the borrower." This formulation clearly establishes a legislative expectation that two business days is the *longest allowable time* for a licensee to process a refund, and that refunds should in fact be processed immediately or within just one business day unless it is not "reasonably possible" to do so. Yet BFI has not addressed this expectation for prompt refunds nor given any guidance about what it would or would not consider to be a reasonable excuse on the licensee's part for not providing a refund immediately or within one business day. This issue clearly would apply in the case of a licensee cashing a check for an amount that exceeds what the borrower actually owes under the loan contract and applicable law. But it also applies more generally in any case where a lender may receive more than is actually owed. *Accordingly, BFI should clarify that lenders must, in general, provide refunds immediately. BFI should also give guidance or examples concerning what a licensee who does not provide refunds immediately or within one business day would have to demonstrate to show that it was not "reasonably possible" to do so.*

We think it is clear that holding a check for an amount greater than the principal due under a single periodic installment payment raises important questions and creates salient potential for legal violations, all of which merit BFI's attention.

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[2] The main thrust of the new law, with respect to chapter 18, is to prohibit large / lump-sum payments and require smaller, more affordable, periodic installment payments. This suggests that BFI should discourage the practice except where necessary and subject to careful oversight. Cashing a large check would create hardships for many borrowers, often including checking account overdraft or non-sufficient funds fees if the borrower does not have sufficient funds to cover the check (many borrowers will not have such large sums available in their accounts at any given time). The legislature expressed a specific interest in avoiding such outcomes for borrowers (see, for example, revised §6.2-1816(11) and (12), which prohibit a licensee from repeatedly attempting to cash a borrower's check or electronically debit a borrower's account). The law attempts to find balance between these concerns and the valid interest of lenders who wish to use checks to secure loans. It will be important for BFI to help maintain this balance through its regulatory, supervision, and enforcement activities.

[3] 4 CCR 902-1-17(F). Note that Colorado's law allows for an origination fee and that the regulator allows the security check to include that fee in addition to loan principal. Since Virginia's Chapter 18 does not allow an origination fee, we ignore it for present purposes.

In summary, we recommend that BFI:

- *Remove the prohibition of holding multiple checks to secure a loan.*
    - *We do not have a recommendation about whether BFI should stipulate a limit on the number of checks held. However, we note that we see two main use cases for holding checks as security. One is to secure the loan principal, and some lenders will find it useful to hold a single large check for this purpose, especially to protect against the not insubstantial risk that some borrowers will default before making a single payment on the loan. The other is to aid in the collection of a required monthly payment. It is our understanding that in other states lenders sometimes require borrowers to submit a new check monthly or periodically to reflect declining loan balance.*
- *Prohibit the amount of a check held as security to include anything other than loan principal (not interest or monthly maintenance fees). BFI should be clear that lenders must never collect unearned interest or maintenance fees from borrowers.*
- *Emphasize that licensees should take reasonable steps to avoid collecting or receiving more than is due on a loan, including in their policies for collecting defaulted/accelerated loans.*
- *Establish a general rule requiring licensees to deliver any refund due to a borrower immediately, and if they ever delay refunds for the legislative maximum of two business days, to provide justification to BFI for why it was not "reasonably possible" to deliver the refunds faster.*

10VAC5-200-70. Additional business requirements and restrictions.

Under item E, we encourage BFI to clarify that the requirement to "sign and date a written loan application" can be conducted electronically as well as on paper to facilitate competition from digital providers and increase consumer choice.

10VAC5-200-75. Annual reporting requirements.

To maximize understanding of Virginia's market and consumer protections under the new law, we encourage BFI to make several modifications to its proposed reporting requirements. This information is available from regulators in many other states and has materially contributed to analyses of the markets in those states.

On item 3, we ask BFI to retain the average dollar amount lent under Chapter 18.
On item 5, we ask BFI to retain the average number of days in a contracted loan term and also to include the average number of days that a loan was outstanding because some borrowers repay, refinance, or default before the full loan term has elapsed.

10VAC5-200-80. Short-term lending pamphlet text.

Under "In General," we recommend BFI change "overdraft protection" to "overdraft line of credit," because under the new legislation, Chapter 18 loans would generally cost less than repeated use of overdraft penalty fees, though still more than an overdraft line of credit.

Under “Fees, Charges, and Interest,” BFI removed the payday loan examples of loan charges in dollar terms (e.g., if the lender advances you $300 for 31 days, the lender may charge you up to $9.30 in interest, a loan fee of $60, and a verification fee of $5.00 for a total of $74.30).

We recommend BFI keep an example demonstrating loan charges in dollar terms in the pamphlet, such as one from 10VAC5-200-60 (A.1), ($300 for 3 months, etc.). In general, seeing examples of the dollar cost of loans provides salient information that helps consumers better understand the loan they are considering and how its cost would compare to other options they may have.

Under “Limitations on Security Interest,” *we note that BFI will need to adjust this section if it chooses to remove the prohibition of holding more than one check under 10VAC5-200-20.*

We also note that the pamphlet is silent about important new protections in the law, such as the right to a prompt refund (the proposed section on “Payment and Prepayments” in the pamphlet does not address the right to receive the refund as soon as reasonably possible for the lender and not later than two business days later); the right to at least 10 days’ notice before the loan can be accelerated and the full amount can become due; the fact that lenders may not attempt to cash a check or electronically debit an account repeatedly unless they get authorization from the borrower (which is voluntary); the fact that lenders may not refuse to accept payment at any time from the borrower any third party making a payment for the borrower’s benefit; and so on. In general, there is not a clear summary of key consumer rights and protections. *We recommend that BFI include notices about some or all of these rights and protections in the pamphlet, presented in a summary format that is easily digestible by a typical borrower.*

10VAC5-200-110. Short-term lending database.

Item 11 requires reporting an applicant’s verified (i) gross monthly income and (ii) net monthly income. Reporting this information to the database is not required by the legislation and BFI has not explained why it proposes to require it. It is not clear to us why a database provider would need this information in order to enforce the rule of a borrower having only one loan at a time. Including this information in the database may raise concerns about increasing the cost of doing business without countervailing benefit to consumers or the public, jeopardizing consumer privacy, or other concerns. Further, it might falsely suggest that lenders may rely on information found in the database when conducting their own verification of an applicant’s income. Since § 6.2-1818.4 requires a licensee to “make a reasonable attempt to *verify* the borrower’s income” [emphasis added], and that this shall include, at a minimum, obtaining at least one piece of written evidence dated within the prior 45 days, we presume that information in the database would not be sufficient to meet this legislative requirement.

We recommend that BFI remove the income requirement from the database. But if BFI determines this information is necessary for the database provider to have, we recommend that (1) “and” be changed to “or,” since lenders are only required to verify gross or *net income, rather than both; and (2) BFI clarify that a lender may not use information about an applicant’s income found in the database to fulfill its statutory duty to verify a borrower’s income, or may not rely solely on the database for that purpose.*

10VAC5-200-115. Database inquiry fee.

The proposed regulations would replace the $5.00 *cap* on the database fee with a *mandatory* $6.98 fee (the current fee is $1.98 per BFI order). This proposal to more than triple the database fee appears to be premised on the expectation of a large decline in loan volume under Chapter 18. But the design of the new legislation and the experiences of other states indicate it is not a given that loan volume will decline markedly in Virginia—in fact, as we explain below, the opposite may be true. Also, as a policy matter, even though the new law does not allow the database fee to be passed along to the borrower, tripling the size of the fee may create adverse consequences that BFI may not have considered. These may include discouraging lenders from providing credit, encouraging lenders to raise the interest and maintenance fees they charge consumers or, if there is no competitive bid process, creating an unfair windfall for the company that happens to hold the database at the expense of Virginia licensees and consumers. We elaborate on these points below.

In our view it is premature to change the database fee as BFI proposes. *We respectfully suggest that any future increase (or decrease) in the database fee should be informed by an assessment of activity under the new law and, ideally, a competitive bid process that protects against giving monopoly power to any individual provider.*

BFI appears to have assumed that volume of loans under Chapter 18 will drop substantially. Such an assumption is unfounded, and possibly incorrect. BFI reported there were 268,097 loans made in 2019 that were subject to Veritec reporting (only loans under Chapter 18). But prior to the new legislation a large (unknown) share of loans issued by payday lenders were structured as open-end credit and therefore not subject to the database covering Chapter 18. Under the new legislation, there is substantially more revenue available to lenders under Chapter 18 than under the revised open-end provisions. There is also more revenue available for Chapter 18 loans than Chapter 22 loans, providing lenders further incentive to use Chapter 18 rather than Chapter 22 or the open-end provisions. Moreover, the new legislation also makes loans between $500 and $2,500 permissible under Chapter 18, which is likely to drive lending in those amounts to Chapter 18 that previously took place under Chapters 15, 22, or the open-end statute.

Virginia's market is likely to mirror the experiences of Ohio and Colorado, which passed similar reforms in 2018 and 2010 respectively and did not experience a decrease in volume as BFI appears to assume will be the case in Virginia. In the first two-thirds of a year after Ohio's reform, there were 216,560 loans under the part of the law corresponding to Virginia's Chapter 18—equivalent to 323,000 if prorated to reflect a full year; in Ohio, borrowing patterns remained stable throughout the course of the year.[4] Similarly, Colorado's most recent year under their corresponding law, the deferred deposit statute (2018), saw 384,109 loans.[5] In the following paragraphs we will use Ohio and Colorado as baselines for estimating potential Chapter 18 loan volume under Virginia's new law. As an initial matter, we note that the comparison likely *underestimates* volume of loans subject to database reporting in Virginia because corresponding laws in each state offer similar pricing but are more restrictive in loan size (whereas Virginia's Chapter 18 allows loans as large as $2,500, Colorado's law limits loans to $500 and Ohio's law limits them to $1,000,). In these other states, loans larger than $500 or $1,000 respectively are only allowable at lower rates under other statutes, implying that the share of loans subject to Virginia's new database reporting may exceed the share of the market reported to regulators in Colorado or Ohio.

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[4] Ohio Division of Financial Institutions, Annual Report for the calendar year ended Dec. 31, 2019, https://www.com.ohio.gov/documents/FIIN_2019_CILA_GLL_SLA_STLA_Annual_Report.pdf.

[5] Colorado Administrator of the Uniform Consumer Credit Code, Comparison of 2018 vs. 2019 Small Dollar Lending, http://coag.gov/app/uploads/2020/11/Annual-Report-Composite-Comparison.pdf.

Virginia's population is 8.65 million people, whereas Colorado's is 5.84 million, and Ohio's is 11.73 million. Adjusting for population size and using published loan volume in other states for comparison, we project that Virginia would see about 569,000 loans under Chapter 18 in 2021 if its experience mirrors Colorado's, or 238,000 if its experience mirrors Ohio's. That is, Virginia can expect to experience a change in Chapter 18 loan volume ranging from a *large increase* (of 300,000 or more loans per year—more than double the volume in 2019) or a *modest decrease* (of about 30,000 loans per year). This strongly suggests that it is not reasonably possible to assess the cost of providing the database on a per-loan basis, raising the possibility that BFI would not meet the legal test required under §6.2-1810(4) ("[t]he schedule shall bear a reasonable relationship to actual cost of the operation of the database.") If anything, this analysis suggests that BFI should be prepared for <u>*an increase in loan volume*</u>, which would likely make the per-loan cost of the database *lower*, not higher.

Accordingly, *we believe any increase in the database provider's fees are unwarranted at this time. Rather, it would be prudent for BFI to see whether the number of loans increases, decreases, or remains roughly the same under Chapter 18 compared to 2019's 268,097 loans before adjusting permissible fees for a database provider*.[6]

Further, if BFI proceeds with exploring a change to the database fee, we respectfully suggest that BFI solicit input from potential providers other than the one that currently holds the database contract in Virginia. For this purpose, we highlight a recent experience from the federal Consumer Financial Protection Bureau when it issued a request for proposals for a payday loan database as part of its 2017 regulations (and a related waiver request for that deadline in January 2018). Public records indicate that at least six companies besides Virginia's current database provider requested a waiver, demonstrating their interest in applying to operate a registered information system for payday loans, similar to the one in place in Virginia.[7] Given this considerable level of interest from market participants, it seems unwarranted to set pricing based only on information from the current provider. It is in fact possible, and advisable, to seek input or proposals from other potential providers before increasing the fees that Virginia licensees will pay for the database.

We note that BFI may be concerned that delaying a fee increase or seeking competitive bids may result in a period of time when a database is not operational. This is a reasonable concern, but we note that setting the database fee in connection with the actual cost of providing the database is a legal requirement, and overall the potential benefits of seeking competitive input and keeping costs low likely outweigh any potential risks of a gap in database coverage. The law allows for such gaps: It is possible

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[6] It may take more than a year to get a good read on market activity under the new law. The Covid-19 pandemic and related economic / policy fallout has reportedly reduced loan volume for payday and similar lenders nationwide. One the one hand, unemployed consumers fail to qualify for loans; and on the other hand, consumers generally have benefitted from government stimulus payments and moratoria against evictions, foreclosures, or late fees that temporarily reduced their reliance on small-dollar loans. Consequently, it may take more than a year for the market to stabilize.

[7] Those companies were Clarity Services, https://www.consumerfinance.gov/documents/6402/cfpb_ris-waiver-request_clarity-services_03-23-2018.pdf; DataX, https://www.consumerfinance.gov/documents/6478/cfpb_ris-waiver-request_datax-llc_04-24-2018.pdf; MicroBilt, https://www.consumerfinance.gov/documents/6420/cfpb_ris-waiver-request_microbilt-corporation-prbc_04-04-2018.pdf; Equifax, https://www.consumerfinance.gov/documents/6428/cfpb_ris-waiver-request_equifax-information-services_04-04-2018.pdf; FactorTrust, https://www.consumerfinance.gov/documents/6422/cfpb_ris-waiver-request_factor-trust-inc_04-02-2018.pdf; and Teletrack, https://www.consumerfinance.gov/documents/6404/cfpb_ris-waiver-request_teletrack_03-27-2018.pdf.

for Chapter 18 licensees to operate without a database in place if necessary, under provisions of §6.2-1810 ("During any period that the database is unavailable due to technical problems beyond the licensee's control, a licensee may rely on the loan applicant's written representations, rather than the database's information, to verify that making the loan applied for is permissible under the provisions of this chapter.") If the current provider of Virginia's payday loan database is not interested in continuing to provide services for its current fee of $1.98 per loan, such provisions would be adequate to sustain lending under Chapter 18 for a reasonable period of time while BFI creates a database or negotiates a new contract as the market evolves.

Accordingly, if BFI decides to raise the database fee that Virginia licensees pay on each loan, we encourage BFI to engage in a competitive bidding process, so that more than one company has the opportunity to provide this service to Virginia and BFI gains better insight into the actual cost of providing such a service as required by the law.

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

Sincerely,

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