The Consumer Finance Podcast: The Impact of State Licensing Laws
Host: Chris Willis
Guests: Joe Reilly and Chris Capurso
Date Aired: November 2, 2023

Chris Willis:

Welcome to *The Consumer Finance Podcast*. I'm Chris Willis, the co-leader of Troutman Pepper's Consumer Financial Services Regulatory Practice, and I'm really glad you've joined us for our episode today, which is going to be an overview of how state licensing laws impact the consumer financial services industry. But before we jump into that, let me remind you to visit and subscribe to our blogs, TroutmanPepperFinancialServices.com and ConsumerFinancialServicesLawMonitor.com. And don't forget to check out our other podcasts. We have lots of them. We have the *FCRA Focus*, all about credit reporting, *The Crypto Exchange*, about all things crypto, *Unauthorized Access*, which is our privacy and data security podcast, and our newest podcast called *Payments Pros*, which is of course all about the payments industry.

And speaking of those other podcasts, you can get them on any popular podcast platform that you like. And if you like this podcast, let us know. Leave us a review on your podcast platform of choice and let us know how we're doing. And don't forget to download and check out our great new mobile app. You can find it in either the Apple or the Google Play Store by just looking for Troutman Pepper. It's a great one-stop shop to access all of our blogs, all of our alerts, all of our podcasts, and even our great handy directory of all the members of our financial services team. So please check that out. As I said, it's available on both iOS and Android and I think you'll really enjoy it if you try it out.

Now, as I said, today's episode's going to be all about licensing, and we're fortunate to have two of my colleagues who spend a lot of their time on licensing related matters to give you all an overview of that process today. We've got Joe Riley, who's in our Washington, DC office, and Chris Capurso who's in Richmond, both of whom work on licensing matters all the time. So gentlemen, welcome to the podcast today.

Joe Reilly:

Thank you, Chris.

Chris Capurso:

Thanks Chris.

Chris Willis:

Joe, licensing is now seeming like such a huge area that affects every aspect of the consumer financial services world, but I think it'd be good for our listeners to hear the historical perspective that you can offer about how do we get to where we are? I mean, where did licensing start and how did we get to where we are today?

Joe Reilly:

Sure, Chris. It really started off in the mortgage industry where there were allegations that mortgage lenders were making loans that consumers really weren’t qualified for, couldn't repay, really causing consumer harm. And it was an effort by the state which the federal government got involved in to start vetting who can make a mortgage loan. We want to make sure that a mortgage lender is a good corporate citizen without records of misbehavior and the like. And so licensing was required first for entities that lend and service loans and then later for individual mortgage loan originators. This history where it began with mortgage is why even to this day, the application score, a licensing of all different types of activities are still done through the NMLS website, the Nationwide Mortgage Licensing System website.

Chris Willis:

Yeah, which if I recall correctly, that was created in the wake of the Safe Act, wasn't it?

Joe Reilly:

The individual licensing requirements, the 2008 Safe Act, that's right.

Chris Willis:

Because there was this perception about mortgage brokers as I recall. So we know it started in mortgage, but today it applies to a lot more. What's been the cause of that sort of rapid proliferation in licensing in the non-mortgage part of the consumer finance industry?

Joe Reilly:

Well, I think there's been an increasing concern that there are actors in the consumer finance space who do not treat consumers very well, and there's a public benefit to requiring folks who want to enter the consumer finance space to submit information about their backgrounds and their financial stability to regulators that's all a part of getting a license. And we've just seen a steady expansion of that over time. After the mortgage lenders, there was licensing of non-mortgage consumer lenders. And today as we'll talk about a little bit more, there's also a requirement for licensing of brokers, of purchasers, and of actors that aren't even involved in lending.

Chris Willis:

I guess corollary to the idea of having a licensing requirement is you have to have one to engage in whatever the underlying activity is, but sometimes folks go out and actually do that activity, whether it's lending or brokering or whatever, and don't have a license. What could happen to them if they are engaged in an activity the state says you need a license for, but they don't have one?

Joe Reilly:

Too many things can happen in that circumstance. Number one, you'll probably be told to stop the activity, which is very obviously disruptive as a business matter. And number two, there can be financial and other consequences to operating in an unlicensed manner. Just to give a few recent examples, last year, Connecticut charged a FinTech with operating as both an unlicensed small loan company and an unlicensed consumer collection agency. That FinTech was required to pay a total of $240,000 in restitutions and penalties. Even more recently, Connecticut cited another unlicensed collector who was made to pay $100,000. California is very active in going after unlicensed actors. And just last month, the Massachusetts Division of Banks assessed a $1.5 million fine against a company for acting as a third-party loan servicer without getting a license. So there are real both business and financial consequences to starting an operation without tending to whether you need a license and going through the license application process.

Chris Willis:

Thanks, Joe. So, let's talk through some of the different types of consumer lending related activity, and I'll go through and name some categories and would like for you and Chris to talk to me about what kind of licensing requirements exist for each of those areas. You talked about mortgages, the background, but let's start with just general consumer lending. Let's say I make just any kind of consumer loan. What kind of licensing requirements are there in the states about that kind of activity?

Joe Reilly:

Yeah, the licensing requirements, Chris, for that type of activity are often based on the finance charges on the loan where you're much more likely to need a license if you're offering higher interest loans. There are also loan amount thresholds. You generally don't need a license for making large loans with the idea that borrowers on large loans can protect themselves, but the smaller the loan gets, the more licensing there is.

Chris Willis:

Okay, got it. How about for brokering loans? Let's say I'm not a lender at all, I'm just assisting another lender in finding customers or hooking them up with the lender and arranging for the loan. Are there states that require a license to do that kind of thing even though I'm not actually making loans myself?

Joe Reilly:

Yes, there are a number of states, probably not a majority that do require a license. If you solicit a consumer for a loan, that would be made by a third party such as a bank and you're paid for that solicitation. There's a big dividing line though on whether you're paid by the consumer, in which case you're much more heavily regulated versus being paid on the backend by the lender in the event of a consummated loan, in which case there's less licensing but still a requirement in a number of states.

Chris Willis:

Okay. And you mentioned, Joe, the history of mortgage, but sitting today, what are the different things that people do in connection with mortgages that require them to have a license?

Joe Reilly:

Lending, servicing and owning. Those are the three categories. You often need a license even to own a mortgage loan even if you didn't make it and you're not involved in servicing it. But the most scrutinized activity is actually making the loans and then servicing them.

Chris Willis:

Chris, let me go to you now and ask you about collections. There's third party debt collection agencies, there's creditors collecting their own debt, there's debt buyers. What kind of licensing requirements exist for those kinds of parties? For the sort of collection function.

Chris Capurso:

Collections is a good area to note that when we refer to licenses, I mean there is the traditional license, but there's also notifications and registrations with state agencies that may have less arduous requirements to getting them. There can also be just simply bond filings where you have to file some kind of surety bond, let the state know you're there and they have some kind of collateral in case things don't go well. But in collections, we talk to clients and sometimes the response is, "Oh, collections, I don't do that. I don't go knocking on the door asking for money. The debt is not defaulted." Things like that. And sure, for example, under the Fair Debt Collection Practices Act, if you begin servicing prior to default, you're fine, but some of these states don't have that same kind of exception and they can require a named collections license just for servicing.

There are also loan servicer licenses in some of these states. Massachusetts comes to mind with its third-party loan servicer license. There could be specific types of debt servicer licensing, like student loan servicer. We're starting to see that a little bit. But collections really kind of runs the gamut. And we're even seeing clients in some cases get approached by regulators for even operating a billing statement service where they may never touch the money. It may just be sending a statement, letting folks know that they owe something maybe in relation to rent, utilities, things like that. Some regulators are taking the position that that is a collections activity because you are seeking payment of money even if you're not collecting it yourself. So, the gamut of activities that could be covered by "collections licensing" runs pretty wide.

Chris Willis:

It probably would be good to point out at this juncture that student loan servicing has been a particular area of state focus recently with a lot of new student loan servicing, licensing statutes coming into being over even just the past couple of years, we've seen a lot of them proliferate. Well, what about auto finance or auto sales, Chris? What kind of licenses are involved in being in the auto sales and finance industry?

Chris Capurso:

When you think of auto finance or installment sales finance, usually think about the sales finance company themselves, the one who is taking assignment of the installment contract that's being sold to them from the dealer or contractor and home improvement finance, the seller to the sales finance company. And there are licenses related to sales finance companies just simply for providing the act. It's kind of a difference between the consumer lending, as Joe said, where there are thresholds on it. It's usually associated with some kind of rate or some kind of dollar amount.

Typically, in sales finance, unless you're in what's called a Uniform Consumer Credit Code state, where there are sometimes dollar amount thresholds on applicability, sometimes it's just related to the act of taking assignment of an installment contract. One thing I did want to note is that sometimes sellers themselves will need to either have a license or a notification just to be the seller in an installment sale. And then even beyond the financing aspect and auto, obviously dealers need to be licensed at the state level, potentially for multiple activities depending on what they're doing, whether they're doing straight up auto sales or auctions or things like that. So installment sales and auto finance in particular can involve quite a bit of licensing.

Chris Willis:

Okay, got it. Joe, leaving the world of lending behind just briefly, I think I've heard about state money transmission related laws. So can you tell the audience a little bit about that?

Joe Reilly:

Yes, and this is the one area of licensing where there is also a federal aspect. The federal aspect is that under the Bank Secrecy Act, any actor that qualifies as a money services business is required to register with FinCEN, the Financial Crimes Enforcement Network, which is the division of the Department of Treasury although you typically have six months after you begin your money services business activity before you need to file that registration. But apart from that, back to the state level, all 50 states now require a license to as a money transmitter, and we're seeing more regulatory scrutiny applied to that space.

Chris Willis:

So, we've certainly got a lot of licensing requirements scattered around the whole consumer financial services ecosystem. Joe, could you talk to the audience about whether there are some types of programs that are more difficult from a licensing perspective?

Joe Reilly:

Yes, thanks, Chris. I did want to talk about bank partnerships for a minute because sometimes there's confusion on that. When a non-bank like a FinTech partners with a bank or a lending program, the only type of licensing that the non-bank avoids are licenses needed to make loans because the bank is going to make the loans in a typical partnership. But the non-bank has to bear in mind that even though it's not making the loans, it may very well be engaged in other activities that could require a license, specifically brokering activity. As I mentioned, if you solicit for compensation, solicit a customer for a loan, that often requires a license, especially if you're being paid by the customer. And then even on the backend in a number of bank partnerships, the non-bank agrees to purchase the loans after the bank makes them and there can be licensing requirements for purchasing and holding loans, which again, as I alluded to earlier, are often tied to the amount of the loan and the rate on the loan. Purchasing higher interest rate loans is more likely to require a license.

Chris Willis:

Okay. And so Chris, turning to you, are there certain states where it's more difficult or more time-consuming to obtain a license than others, or are they all kind of created equal?

Chris Capurso:

They're not all created equal. It's kind of akin to the discussion around state AGs and it seems the maxim is the blue states are a little bit more difficult than the red states. The same goes with licensing and licensing regulators. You think of the Northeast, you think of California as being states where the licensing burden can be particularly onerous and also where the regulators are on top of it as far as trying to find violations and really enforcing their laws. But that's not even to say that red states are lax. There are some very intense licensing requirements in the middle of the United States. You think of Texas. Texas has a lot of licensing regimes. As far as the regulators, we do seem to find that the more prickly ones are from the blue states and the Northeast and California and places like that, but don't sleep on the red states as far as how difficult some of the licensing requirements can be and how the regulators approach them.

Chris Willis:

Well, it seems like from listening to the two of you, that there's really kind of a bewildering array of state licensing requirements, and each one is unique to the state that's imposing it. What do we do? What does our licensing practice, which you lead, do to help clients in this area?

Joe Reilly:

Well, Chris, we have well-oiled machine here that routinely delivers licensing surveys and licensing gap analysis for clients, starting with the actual discussion with the client about exactly what type of activity they intend to do. We then take those set of facts and we bump them up against the 51 jurisdictions licensing requirements and then generate a chart for the client so the client knows what its risks would be in terms of operating in an unlicensed capacity.

Chris Willis:

Okay. Chris, what about you? Do you have anything to add in terms of our service offering here?

Chris Capurso:

Absolutely. And I want emphasize, Joe mentioned that statement of facts that we brought up against all the state licensing requirements. And that statement of facts is vital because the slightest change and all of a sudden there's a different type of analysis that goes on, it feels like a butterfly effect. You change one little thing in that statement of facts, and all of a sudden, the output that is our licensing survey and the conclusions in it can change significantly based on what a client may see as one small thing.

But in addition to those licensing surveys that Joe has mentioned, we also do licensing gap analysis related to due diligence. For example, mergers and acquisitions. If somebody is acquiring a target who has licenses or should have licenses, we'll go in for the acquiring company and analyze that and try to figure out, one, do they have what they need? Two, what would it take to get what they need? And three, have a sort of exposure analysis, try to figure out what could be the damage, how much business have they done there? What could the potential penalties be if we apply for a license now? What could happen? So we help clients with that.

And the other aspect of licensing that we help with is applications. We can put together checklists to help clients understand exactly what they have to do, because some states can be particularly onerous. Most states have some kind of fingerprinting, financial disclosures, things like that. But some states require certain types of business plans. They require certain types of documents. We can help put together checklists to try to figure out what somebody will need in a specific state. We can also put together checklists that go state by state so we can kind of identify the common requirements to make it easier for a client to say, "Okay, if I do this one thing, then that will satisfy all these states." And just try to make it, as Joe said, a well-oiled machine so the client can get everything they need.

And to the extent it's helpful, we can help clients in the licensing process. I sort of equated to a help box. When they come to a question in NMLS or in the licensing application, it's like, "What does this mean?" You can chat with us and try to figure out exactly what it means, what the response would be. We can help clients with quite a few things in the licensing realm.

Chris Willis:

Yeah, and I guess I would probably follow that by emphasizing that once you have a license, you're subject to examination by the state regulator that gave you the license. And some of those state exams are not too difficult and we find clients handle them fine on their own. But there are some states, like New York DFS for example, that have very, very in-depth examinations. And so we find ourselves regularly assisting clients with examinations from those regulators because they tend to be incredibly involved in some instances.

Joe, Chris, thank you very much for being on the podcast today. I know I've learned a lot and I'm sure our listeners have as well. And of course, thanks to our listeners for tuning in today as well. Don't forget to visit and subscribe to our blogs, TroutmanPepperFinancialServices.com and ConsumerFinancialServicesLawMonitor.com. And while you're at it, why don't you head on over to Troutman.com and add yourself to our Consumer Financial services email list? That way you'll get copies of the alerts that we send out and invitations to our industry only webinars. And of course, as I said at the beginning of the show, don't forget to check out our really nifty mobile app available on both the iOS and Android stores. Just look for Troutman Pepper and you can find it, and I think you'll find it to be a really great way to have a one-stop shop to access all of the thought leadership content we put out for the financial services industry. And finally, of course, stay tuned for a great new episode of this podcast every Thursday afternoon. Thank you all for listening.