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STATE OF VERMONT
OFFICE OF THE ATTORNEY GENERAL
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05609-1001

March 31, 2014

Janet O. Estep, President and CEO
NACHA – The Electronic Payments Association
13450 Sunrise Valley Drive, Suite 100
Herndon, VA 20171

Via Certified Mail, Email

Re: Illegal Lending in the State of Vermont

Dear Ms. Estep

We are writing to join in the recent efforts of several states to combat illegal and predatory lending activities,¹ and to advise you of a specific Vermont law directly applicable to the payment processors involved in these activities. Specifically, Vermont law (9 V.S.A. § 2481w) applies various lending requirements, via the state Consumer Protection Act, to both the lenders themselves and payment processors. We believe your organization is in a unique position to help combat fraudulent transactions involving payment processors.

We respectfully request that NACHA advise all payment processors to prevent unauthorized consumer loan transactions² For example, on August 9,

¹ For example, on August 5, 2013, New York (through its Department of Financial Services) sent a letter requesting NACHA's assistance in combating illegal loan activities.

² While the term "payday loans" is often used to describe the kinds of loans at issue, there are several types of loans that violate Vermont (or state) law that are not strictly speaking, "payday loans." Vermont's prohibition on "unauthorized or illegal lending," refers to (i) payday loans (i.e., loans contingent on future or postdated checks); (ii) any unlicensed lender who has not obtained the required state license to make loans (including online lenders); and (iii) any loan made in excess of Vermont's usury cap (ranging from 12-24% per annum)

2013, NACHA sent a letter to the Originating Depository Financial Institutions (“ODFIs”) advising that. “purported authorizations to pay illegal loans that are unenforceable under applicable state law do not constitute valid authorizations under the NACHA Rules.” (Emphasis original.) On March 14, 2013, NACHA issued an “Operations Bulletin” also advising ODFIs of potentially illegal transactions in reference to payday lending. We applaud that effort to involve the ODFIs, and we request a similar letter and “Operations Bulletin” addressed to the payment processors.³ The letter should advise payment processors of Vermont’s law, and suggest that processors nationwide follow the same guidelines.

In support of this request, below we provide background on Vermont’s regulation of lenders and processors, followed by our suggested proposal.

I. Vermont’s Regulation of Lenders

Like many states, Vermont regulates several aspects of commercial money lending, including by (1) requiring a lender to have a state license, or be a bank or a credit union, to make loans or even solicit loans (*see* 8 V.S.A. §§ 2201, 2233(b)), and (2) capping interest rates at 12-24% annually (*see* 9 V.S.A. § 41a(b))

Failure to comply with lending laws has wide ranging and damaging effects on consumers, in Vermont, and generally. As the Center for Responsible Lending recently described, payday loans are “designed to trap individuals in long-term debt” and have a “devastating impact on families’ financial well-being.”⁴ Contrary to industry defenses, the loans are not typically used for short-term or emergency expenses.⁵ As the CFPB found in its 2013 study on payday loans, most consumers remain indebted up to a year on these supposed “short-term loans.”⁶

³ We also understand that NACHA maintains a “watch list” of high-risk ODFIs and third-party processors, *see* <https://www.nacha.org/originator-watch-list>, but that the list is not publicly-accessible

⁴ *See* Center for Responsible Lending, “CRL issue Brief,” October 4, 2013, *available at* <http://www.responsiblelending.org/payday-lending/research-analysis/State-Enforcement-Issue-Brief-10-4-FINAL.pdf>

⁵ *See* National Consumer Law Center, “Stopping the Payday Loan Trap,” June 2010 (“Various studies have found that 40 to 60% of consumers take out payday loans to cover routine expenses like utility bills, rent or groceries, or nonessential items”), *available at* http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/report-stopping-payday-trap.pdf.

⁶ *See* Consumer Financial Protection Bureau, *Payday Loans and Deposit Advance Products. A White Paper of Initial Data Findings*, April 24, 2013 (p. 38), *available at* <http://bit.ly/CFPBPaydayPaper>

In Vermont, with a population of less than 630,000, our office has investigated one lender who funded 384 loans (\$197,000 in principal) and earned \$230,000 in interest and fees alone, at an average annualized interest rate over 300%, another lender funded 296 loans (\$144,000 in principal), and earned almost \$145,000 in interest and fees. As to individual examples, one Vermont consumer complained of taking out a \$400 online loan (at over 300% annualized interest) and paying back over \$1,000 within five months (mostly through automatic withdrawals that required bank intervention), another complained of an online lender depositing \$160 in a small loan to his bank account, and then automatically withdrawing \$100 every month in “fees” (resulting in annualized interest of 747%)

In enforcing Vermont law, we have identified over 70 illegal lenders. See attached Exhibit A. These lenders have been directed to cease all unauthorized lending in Vermont, and to return all monies unlawfully collected from Vermont consumers. Vermont continues to pursue those lenders who fail to comply; however, such actions are increasingly insufficient to address the problem

II. Vermont’s Regulation of Payment Processors

As you may be aware, focusing solely on the lenders is often inefficient and ineffective. Many of these lenders operate online, have several affiliated companies, and change their business names often, all to obscure both their location and the true lender-in-interest. Other lenders claim tribal immunity or are located off-shore and in foreign countries, adding further complications for enforcement.

Therefore, Vermont passed legislation in May 2012 making payment processors directly liable for transactions on behalf of unlicensed or usurious lenders. Under 9 V.S.A. § 2481w(c), it is:

“an unfair and deceptive act and practice in commerce for a processor, other than a federally insured depository institution, to process” any payment “from a consumer’s financial account in connection with a loan . . . unless the lender” has complied with all lending requirements of Title 8 of Vermont law or is a bank or credit union

Under the Consumer Protection Act, the Attorney General is authorized to enforce this provision and seek strong remedies, including consumer restitution of all amounts paid. That means a payment processor (who may have received only a nominal processing fee) would be directly liable for the entire amount processed from a consumer’s bank account in connection with a loan from an unlicensed lender. Those transactions add up to significant dollar amounts, especially since many of them include usurious interest.⁷ The processors could also be liable for

⁷ The typical annual interest rate for unlicensed loans is 300%, and often the rates are even higher

civil penalties, and subject to an injunction ordering all processing on behalf of unlicensed lenders to cease in Vermont.

To comply with the above, we understand that payment processors do not necessarily know the location of borrowers or whether a lender has a required state license. We do not suggest that processors are responsible for information that they cannot uncover. However, the processors do have consumer bank account and routing number information, and can easily ascertain the location of the borrower's bank. Thus, processors can easily comply with Vermont's law – before processing a loan payment from a Vermont bank, the processor should require the lender to (i) produce a Vermont lender's license; (ii) provide evidence that it is duly chartered as a bank or a credit union, or (iii) certify that it is not doing business in Vermont.

Alternatively, and even simpler, the processor could ask any lender signing up for processing services: "Will you be processing from any Vermont consumers?" [the lenders know consumer residence/location information] If the answer is "yes," the processor should require proof of state licensure or proof that they are a bank or a credit union. This protocol should be adopted nationwide. Similar to the "get to know your customer" due diligence protocols for banks, processors should "get to know" their client-lenders. In a typical processing arrangement, the processor is well aware that a client is requesting electronic payment processing for loan transactions. A processor need only ask for proof of state law compliance.

As a third alternative, the processor can directly verify licensure, using the below websites. All non-bank lenders who are authorized to lend in Vermont are listed in either of the following two websites.

- (1) The national website hosted by Nationwide Mortgage Licensing System & Registry
 - <http://www.nmlsconsumeraccess.org/> – enter the name of the company and check for Vermont under "State Licenses/Registrations" results.
- (2) Vermont's state agency website hosted by Dept. of Financial Regulation.
 - <http://www.dfr.vermont.gov/banking/verify-license> – enter "Licensed Lender" in the first drop-down box ("Select a license").

Additionally, Vermont will be sending future alerts of illegal lenders via a distribution email list. Processors should email: UnlicensedLending-request@list.state.vt.us, to join the list and receive those monitoring alerts.

III. Vermont's Request for Assistance


Given its position and oversight of payment processors, NACHA is well-suited to address the payment processing aspect of illegal loan activities.⁸ We understand that NACHA recently considered, but decided against, adopting new rule changes regarding return reason codes (which potentially might address unauthorized transactions and illicit merchants) In that decision, NACHA stated its intention to “provide more education to the industry ” We suggest the following guidance from NACHA to further educate the payment processing industry

First, we ask that NACHA put out an advisory or bulletin (perhaps an “ACH Operations Bulletin” that NACHA regularly issues) that. (i) announces Vermont’s unique law, (ii) advises all payment processors of their potential direct liability should they do business in Vermont on behalf of an illegal lender, (iii) provides the above instructions to check lender compliance in Vermont, and (iv) attaches “Exhibit A” as a minimum list of all illegal lenders that processors should cease processing for (or verify before doing any processing) in Vermont We have enclosed such a proposed draft advisory, and would be glad to work with you in revising or drafting the appropriate language

Second, we suggest that NACHA send a broader letter or announcement to its members and any other relevant bodies, advising payment processors to follow these practices nationwide. Such announcements would have a strong deterrent and remedial effect on this very important and growing public concern. We have also sent a similar letter today to the Electronic Transactions Association ([see www.electran.org](http://www.electran.org)), and Third-Party Payment Processors Association ([see www.tpppa.org](http://www.tpppa.org)), requesting their assistance in this regard

We would be happy to discuss our law further and how we can work together to eradicate illegal and predatory lending. Please contact this office with any questions. Thank you for your assistance

Sincerely,


Justin E. Kolber
Assistant Attorney General

Enc. Exhibit A – “Vermont Illegal Lender List April 2014”
Proposed draft “Advisory – Alert – Bulletin”

⁸ According to NACHA’s website, “NACHA manages the development, administration, and governance of the ACH Network, the backbone for the electronic movement of money ” See <https://www.nacha.org/aboutus>.

ADVISORY - ALERT – BULLETIN

To: All Payment Processors

From: NACHA

Date: April 2014

Re: Processing electronic funds transfers in or into Vermont

Please be advised that it is a violation of the Vermont Consumer Protection Act for any payment processor (other than a bank or credit union) to process electronic funds from consumer bank accounts in Vermont in connection with a loan, unless the lender is a bank or credit union, or has a valid state license to lend money in Vermont. The full text of the law is copied below:

- “It is an unfair and deceptive act and practice in commerce for a processor, other than a federally insured depository institution, to process a check, draft, other form of negotiable instrument, or an electronic funds transfer from a consumer's financial account in connection with a loan solicited or made by any means to a consumer unless the lender is in compliance with all provisions of 8 V.S.A. chapter 73 or is otherwise exempt from the requirements of 8 V.S.A. chapter 73.” [9 V.S.A. § 2481w\(c\)](#).

If you are a payment processor, you are **advised to cease** processing in Vermont on behalf of the entities listed in the attached “Exhibit A.” You are **further advised to inquire** of all lenders who request your processing services: **(1) whether the lender is processing any loans with Vermont consumers; and if so (2)(a) to produce a Vermont lender’s license, or (b) to provide evidence that they are duly chartered as a bank or credit union.**

You may also verify a non-bank lender’s license yourself, by checking the following websites:

- <http://www.nmlsconsumeraccess.org/> – enter the name of the company and check for Vermont under “State Licenses/Registrations” results.
- <http://www.dfr.vermont.gov/banking/verify-license> – enter “Licensed Lender” in the first drop-down box (“Select a license”).

IMPORTANT: *If the lender is not a bank, not a credit union, and is not licensed in Vermont, you should **not** process any funds for them involving Vermont bank accounts.* Doing so would violate section 2481w(c) above and could subject you to significant legal liability, including financial responsibility for **all** amounts processed from a Vermont consumer’s bank account, civil penalties of up to \$10,000 per violation, and injunctive relief. See [9 V.S.A. § 2458](#).

LASTLY, *we suggest you make similar inquires for **all your lending clients nationwide.*** “Are they required to have a state license in the states from which they will withdraw money?” “Are they in compliance with all state requirements for lending activities, such as interest rate caps?” These due diligence questions are an important part of responsible processing and will help assist in protecting consumers from fraudulent transactions. THANK YOU.