Department of Banking Issues Industry Guidance Regarding Public Act 23-126
September 11, 2023

The Department of Banking ("Department") has received several inquiries concerning P.A. 23-126, An Act Concerning Various Revisions to the Banking Statutes, and the need for licensure pursuant to Sections 36a-555 to 36a-573, inclusive, of the Connecticut General Statutes ("Small Loan Lending and Related Activities Act") by entities seeking to engage in small loan activities on and after October 1, 2023. Pursuant to the authority set forth in Section 36a-1-8 of the Regulations of Connecticut State Agencies, the Department hereby issues this guidance to assist industry participants in evaluating the need for licensure and the effect of the various requirements set forth in P.A. 23-126.

Summary of Significant Changes to Small Loan Lending and Related Activities Act as a Result of P.A. 23-126

1. ***Amount***: Increases the dollar limit of "small loans"[1] subject to small loan regulatory requirements from $15,000 to $50,000.

2. ***Annual Percentage Rate ("APR")***:
   a. Changes the calculation of the APR from the federal Truth-in-Lending Act (15 USC 1601 et seq.) ("TILA") to the Military Lending Act (10 USC 987 et seq.) ("MLA").

   b. Deems the following to be "finance charges" for purposes of calculating the APR:
      - a charge for any ancillary product, membership or service sold in connection or concurrent with a small loan,
      - any amount offered or agreed to by a borrower in furtherance of obtaining credit or as compensation for the use of money, and
      - any fee, voluntarily or otherwise, charged, agreed to or paid by a borrower in connection or concurrent with a small loan.

3. ***"True Lender" Inclusion***: Requires licensure of "true lenders" that have partnered with banks to make small dollar loans.

Effective October 1, 2023, these changes will be interpreted as applying to licensable activities concerning a "small loan" as such term is defined on and after October 1, 2023. Licensable activities are set forth in Section 36a-556(a) of the Small Loan Lending and Related Activities Act, and include, but are

[1]The term "small loan" used herein refers to "any loan of money or extension of credit, or the purchase of, or an advance of money on, a borrower's future potential source of money, including, but not limited to, future pay, salary, pension income or a tax refund, if (i) the amount or value is fifty thousand dollars or less, and (ii) the APR is greater than twelve per cent as set forth in Section 36a-555 of the Small Loan Lending and Related Activities Act, as amended by P.A. 23-126.

not limited to, making or offering a small loan, receiving principal and interest on a small loan, acquiring a small loan, and generating leads for a small loan.

Increases Dollar Threshold from $15,000 to $50,000

Prior to October 1, 2023, the definition of "small loan" captured loans in amounts of $15,000 or less. On and after October 1, 2023, the definition of "small loan" captures loans in amounts of $50,000 or less. Consumer loans in excess of $50,000 are outside the scope of the Small Loan Lending and Related Activities Act but may be subject to the general usury provisions set forth in Title 37 of the Connecticut General Statutes.

APR Calculation Utilizing the Military Lending Act

A loan must have an APR greater than 12% to be considered a "small loan". Effective October 1, 2023, the APR definition references the MLA rather than TILA. The MLA includes more fees in the calculation of its APR, including, but not limited to, fees for credit insurance and credit-related ancillary products sold in connection with the transaction.

Costs and Fees Deemed Finance Charges

Prior to P.A. 23-126, the Department evaluated fees, charges and payments, including voluntary payments such as tips, donations and memberships, that were offered and made by borrowers in connection with a small loan on a case-by-case basis to determine whether they were an incident to or a condition of the extension of credit and constituted finance charges under TILA[2]. P.A. 23-126 now expressly states that fees for any ancillary product, membership or service sold in connection or concurrent with a small loan, any amount offered or agreed to by a borrower in furtherance of obtaining credit or as compensation for the use of money, and any fee, voluntarily or otherwise, charged, agreed to or paid by a borrower in connection or concurrent with a small loan shall be deemed finance charges and included in the transaction's APR calculation.

True Lender Analysis

P.A. 23-126 also codifies existing common law "true lender" principles in Section 36a-556(d) to require licensure of partners to banks[3] when any of the following conditions are met:

- such person holds, acquires or maintains, directly or indirectly, the predominant economic interest in a small loan; or
- such person markets, brokers, arranges or facilitates the loan and holds the right, requirement or right of first refusal to purchase the small loans, receivables or interests in the small loans; or

[2]12 CFR 1026.4 of Regulation Z provides, in pertinent part, that, "[t]he finance charge is the cost of consumer credit as a dollar amount. It includes any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit." *See* *Temporary Order to Cease and Desist, Order to Make Restitution, Notice of Intent to Issue Order to Cease and Desist, Notice of Intent to Impose Civil Penalty and Other Legal and Equity Relief and Notice of Right to Hearing in the Matter of: SoLo Funds Inc.* issued on May 4, 2022 in which the Department alleged that "voluntary" payments made by borrowers constitute "finance charges" under TILA.

[3]The term "bank" used herein refers to all persons exempt pursuant to Section 36a-557(b) of the Small Loan Lending and Related Activities Act, as amended by P.A. 23-126.

- the totality of the circumstances indicate that such person is the lender and the transaction is structured to evade the requirements of Sections 36a-555 to 36a-573, inclusive.

These standards are consistent with existing legislation in various other states, including Illinois[4], Maine[5] and New Mexico[6], and "true lender" principles set forth in caselaw and enforcement matters. "True lender" regulation seeks to prevent non-banks from avoiding APR restrictions set forth in Connecticut's Small Loan Lending and Related Activities Act through partnerships with banks.

"True lender" arrangements have been the subject of regulatory scrutiny for over a decade. For example, *In the Matter of People of the State of New York v. County Bank of Rehoboth Beach*, Del., 45 A.D.3d 1136 (2007), New York's Attorney General brought an enforcement action against non-bank lenders that entered into partnerships with banks, alleging that the non-bank lenders were the true lenders and that their agreements with the banks sought to circumvent New York's usury laws. The court noted that the payday lenders purchased 95% of each of the bank's loans, assumed all risks of the loans, and indemnified the bank against any loss arising from a loan transaction, advising that "an examination of the totality of the circumstances surrounding this type of business association must be used to determine who is the 'true lender,' with the key factor being 'who had the predominant economic interest' in the transactions". *Id*. at 1138. *See also Cashcall, Inc. v. Morrisey*, 2014 W. Va. LEXIS 587 (applying predominant economic interest test to determine that CashCall was the true lender in its bank arrangement and, therefore, subject to West Virginia usury laws).

With the passage of P.A. 23-126, the Department will consider the true lender factors set forth in Section 36a-556(d), as amended, and caselaw precedent construing such factors, to determine whether loans made on and after October 1, 2023, should be exempt or comply with the provisions of the Small Loan Lending and Related Activities Act, including APR limitations. Previously, loans made by banks were generally exempt from the provisions of the Small Loan Lending and Related Activities Act pursuant to Section 36a-557(c). In addition, persons who service loans made by a bank pursuant to a "true lender" arrangement on and after October 1, 2023, will no longer be exempt from licensure pursuant to Section 36a-557(a)(3) of the Small Loan Lending and Related Activities Act, as amended. Persons who engage in front-end processes, set forth in subdivisions (2), (3) and (6) of Section 36a-556(a), for bank made loans, or purchase, acquire or receive assignment of a small loan made by a bank pursuant to subdivision (5) of Section 36a-556(a) have always required, and will continue to require, licensure under the Small Loan Lending and Related Activities Act.

Transactions Covered by the Small Loan Lending and Related Activities Act

P.A. 23-126 also streamlines the definition of "small loan" to provide greater clarity concerning the types of transactions covered by the Small Loan and Related Activities Act. Specifically, "small loan" is now defined as:

> [A]ny loan of money or extension of credit, or the purchase of, or an advance of money on, a borrower's future potential source of money, including, but not limited to, future pay, salary, pension income or a tax refund, if (i) the amount or value is fifty thousand dollars or less, and (ii) the APR is greater than twelve per cent. . . . .

[4]815 ILCS 123/15-5-15.
[5]9-A M.R.S. § 2-702.
[6]N.M. Stat. Ann. § 58-15-3.

In substance, the revised definition remains the same as the previous iteration concerning the types of transactions considered to be "small loans", which had been in effect since July 1, 2016. Specifically, Public Act 16-65 had amended the definition of "small loan" to mean:

> [A]ny loan of money or extension of credit, or the purchase of, or an advance of money on, a borrower's future income where the following conditions are present: (A) The amount or value is fifteen thousand dollars or less; and (B) the APR is greater than twelve per cent. For purposes of this subdivision, "future income" means any future potential source of money, and expressly includes, but is not limited to, a future pay or salary, pension or tax refund.

In contrast, rather than using the term "future income" and subsequently defining it, P.A. 23-126 streamlines the small loan definition by removing this intermediary definition.

Examples of non-traditional loan products generally covered by the Small Loan Lending and Related Activities Act include, but are not limited to, lawsuit settlement advances, inheritance advances, earned wage access advances and income share agreements when those transactions fall within the statutory definition of a "small loan". Although the Department recognizes that each type of transaction must be evaluated on a case-by-case basis, an advance of money on an individual's future potential source of money of $50,000 or less with an APR greater than 12% will likely be covered by the Small Loan and Related Activities Act.

Analysis Concerning "Earned Wage Access" Advances

As noted above, advances of money on future wages or salary that have been earned but not yet paid, commonly referred to as "earned wage access" products, are generally covered by the Small Loan Lending and Related Activities Act. Such products are sometimes offered to employees by employers working with third-party earned wage access providers or are offered by such providers directly to borrowers. Charges and fees incurred by borrowers in connection or concurrent with such earned wage access advances may include (a) charges for ancillary products, memberships, or services, (b) amounts offered or agreed to by a borrower to obtain the advance, or (c) voluntary or other fees charged, agreed to or paid by a borrower, including "tips".

To determine whether a particular earned wage access product or transaction is within the meaning of "small loan" as defined by the Small Loan Lending and Related Activities Act, the Department utilizes well established principles of statutory construction. Those principles dictate that words and phrases not otherwise defined within the statutory scheme must be construed according to their common usage, and if the meaning of such words and phrases is plain and ambiguous, extratextual evidence shall not be considered[7]. Unlike other states' statutory schemes, Connecticut's small loan definition only has three components: (1) the $50,000 dollar amount limit, (2) the 12% APR threshold, and (3) the type of transaction, i.e., loan of money, extension of credit, or purchase of, or an advance of money on, a borrower's future potential source of money.

Accordingly, transactions where monies are advanced to consumers for future wages or salary that have been earned but not yet paid, are within the statutory definition of "small loan" when the amount is $50,000 or less and the APR exceeds 12% when taking into account any amounts paid deemed to be

[7]See, e.g., Sections 1-1(a) and 1-2z of the Connecticut General Statutes, *Picco* v. *Town of Voluntown*, 295 Conn. 141 (2010), *Vincent* v. *New Haven*, 285 Conn. 778 (2008), *Chatterjee* v. *Commissioner of Revenue Services*, 277 Conn. 681 (2006).

finance charges pursuant to P.A. 23-126. The Department understands that there are a variety of business models related to "earned wage access" products and invites providers to contact the Department with any fact specific questions.

Necessity of Small Loan Licensure

The threshold questions in evaluating the need for small loan licensure are whether: (A) the transaction meets the definition of a "small loan" as of October 1, 2023, and (B) the related activity fits within the categories set forth in Section 36a-556(a):

(1) Making a small loan to a Connecticut borrower; or

(2) Offering, soliciting, brokering, directly or indirectly arranging, placing or finding a small loan for a prospective Connecticut borrower; or

(3) Engaging in any other activity intended to assist a prospective Connecticut borrower in obtaining a small loan, including, but not limited to, generating leads; or

(4) Receiving payments of principal and interest in connection with a small loan made to a Connecticut borrower; or

(5) Purchasing, acquiring or receiving assignment of a small loan made to a Connecticut borrower; or

(6) Advertising or causing to be advertised in this state a small loan or any of the services described in subdivisions (1) to (5), inclusive, of this subsection.

If a transaction fits within the definition of a "small loan", the Department will then analyze the specific "small loan" activity at issue. Subdivisions (1), (2), (3) and (6) of Section 36a-556(a) are clearly applicable to "small loan" activity on and after October 1, 2023, as all such activity which triggers the licensure requirement (making small loans, offering, soliciting, brokering, directly or indirectly arranging, placing or finding a small loan, engaging in any other activity intended to assist a prospective Connecticut borrower in obtaining a small loan and advertising small loans) occurs prior to, or concurrent with, the small loan.

However, whether subdivisions (4) and (5) of Section 36a-556(a) apply to "small loan" activity on and after October 1, 2023, is less clear because the activity which triggers licensure occurs after the loan is made. This creates the potential for licensable activity to occur after October 1, 2023, concerning a loan made before October 1, 2023, that may not have been considered a "small loan" on the date it was made. Therefore, the following guidance will apply in these circumstances:

- **Loans between $15,000 and $50,000 made prior to October 1, 2023:**

For loans originated and made to borrowers in amounts between $15,000 and $50,000 prior to October 1, 2023, the Department recognizes that the statutory scheme regulating small loans in these amounts was not in effect and therefore did not require small loan licensure for persons servicing or acquiring these loans. As such, the Department will not require licensure for activity set forth in subdivisions (4) and (5) of Section 36a-556(a) for such loans post October 1, 2023.

For example, an entity may wish to engage in servicing activity, i.e., receiving payments of principal and interest, on November 1, 2023, for a $45,000 loan that meets the definition of "small loan"

as of October 1, 2023, but was made on April 1, 2023. The definition of "small loan" on April 1, 2023, only captured loans in amounts of $15,000 or less, and would not have captured such loan. Therefore, the entity would not require small loan licensure on November 1, 2023, to service such loan.

- **Loans of $15,000 or less made prior to October 1, 2023:**

The Department will require small loan licensure of persons acquiring or servicing small loans in amounts of $15,000 or less originated prior to October 1, 2023, that have finance charges, such as voluntary payments and membership fees, causing the APR to be in excess of 12%. Although changes to the definition of "APR" specifying such fees as finance charges become effective on October 1, 2023, such finance charges were previously contemplated and subject to scrutiny by the prior statutory scheme. Accordingly, any entity that engages in activity set forth in subdivisions (4) and (5) Section 36a-556(a) for a small loan of $15,000 or less after October 1, 2023, must be licensed.

No-Action Position

Pursuant to Section 36a-1-8 of the Regulations of Connecticut State Agencies, the Commissioner will not take enforcement action alleging unlicensed activity in violation of Section 36a-556(a) of the Small Loan Lending and Related Activities Act against a person that, as a result of P.A. 23-126, newly requires licensure for small loan activities effective October 1, 2023, so long as such person has filed an application for small loan company licensure in Connecticut on the Nationwide Multistate Licensing System and Registry on or before October 1, 2023.