Virginia Legislature Contemplates Radically Reshaping Existing Interest Rate Authority for Many Lenders

January 31, 2025 | Catherine M. "Cathy" Brennan and Rebecca E. Kuehn

Virginia's Interest and Usury Chapter (the "Chapter"), found in the Financial Institutions and Services Title of the Virginia Code, sets out basic rules for what rates of interest various entities may charge in the state. The general rule in Virginia is that "(e)xcept as otherwise permitted by law, no contract shall be made for the payment of interest on a loan at a rate that exceeds 12 percent per year" ("General Rule").[i] The Chapter provides numerous exceptions to the General Rule, including specific exceptions for different types of lenders as well as different types of loans in Article 4, entitled "Loans Exempt from Limit on Contract Rate of Interest." Article 4 permits a bank or savings institution, regardless of where the bank or savings institution is headquartered,[ii] to impose finance charges and other charges and fees at such rates and in such amounts and manner as the borrower has agreed in connection with an installment loan.[iii]

In an effort to curtail perceived abuses by out-of-state banks lending to Virginia borrowers over the Internet at rates that exceed the General Rule, the Virginia Legislature is considering Senate Bill Number 1252 ("SB 1252").[iv] SB 1252 amends the "anti-evasion" subsection of the Chapter to state that the General Rule "shall apply to any person who seeks to evade its application by any device, subterfuge, or pretense whatsoever," including persons "(m)aking, offering, assisting, or arranging a debtor to obtain a loan with a greater rate of interest, consideration, or charge than permitted under (the General Rule) through any method, including mail, telephone, Internet, or any electronic means, regardless of whether the person has a physical location in the state."[v] SB 1252 further amends the definitions in the Chapter to define "make" or "making" as, when used in reference to a loan, advancing, offering to advance, or making a commitment to advance funds to a borrower for a loan.[vi]

The language is broad enough to capture all third-party vendors (including marketing and direct mail agencies) that assist banks, including Virginia banks. If SB 1252 is passed as it currently exists, banks (including Virginia banks) that use any third-party vendor to originate loans that exceed 12% per year would be in violation of the statute. Significantly, the proposed amendment to the "anti-evasion" subsection also impairs other exceptions to the General Rule under Article 4, including Va. Code Ann. § 6.2-317, which allows all lenders to originate business-purpose loans of $5,000 or more at any rate of interest. Such business-purpose lenders face a voiding penalty if they originate their loans with the assistance of a third party.

Banks, especially community banks, increasingly work with financial technology companies ("fintechs") to expand their offerings in a cost-effective manner. Although large banks have the ability to invest sizable capital into technology, smaller banks do not. Fintechs act as service providers to banks and offer technology-based solutions that the bank could not financially develop on its own. This collaboration has extended to lending, where banks work in conjunction with their technology service providers to provide credit to businesses and individuals.

In consumer lending, banks increasingly work with fintechs to offer loans of differing amounts, durations, and pricing to individuals seeking credit. Because of the wide use and availability of online access (through computers and smartphones), almost any consumer can search for credit through an array of competing products to help them with their credit needs, including installment loans, lines of credit, cash advance and Buy Now Pay Later.

The bank and the fintech generally memorialize their commercial arrangement in a set of contracts that carry legal and regulatory requirements. Banks are highly regulated by state and federal officials who oversee their activities for compliance with a myriad of laws and regulations, including consumer protection laws and safety and soundness standards. Fintechs that act as service providers to the banks are subject to a high level of scrutiny from the bank and the regulator. For example, on May 3, 2024, the Office of the Controller of Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation (the "Agencies") published "the Third-Party Risk Management: A Guide for Community Banks" [vii] as a resource for community banks to bolster their third-party risk management programs. The Agencies had also published an "Interagency Guidance on Third-Party Relationship: Risk Management,"[viii] providing principles that banking organizations may consider when developing and implementing risk management practices for all stages in the life cycle of third-party relationships.

Furthermore, contrary to the assertions of some consumer advocates, fintechs generally operate with a high number of regulatory requirements. Fintechs also contractually agree, as the service provider of the banks, to comply with the panoply of consumer financial services laws that apply to consumer lending and they may need to comply with specific requirements in certain states, depending on what functions they are performing as service providers to the bank.

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[i] Va. Code Ann. § 6.2-303(A).

[ii] The Chapter defines "bank" as "any national bank, any bank organized under Chapter 8 (§ 6.2-800 *et seq.*), or any bank incorporated and organized under the laws of another state." Va. Code Ann. § 6.2-300. "Savings institution" means any savings institution, as defined in § 6.2-1100, incorporated and organized under the laws of the United States, the Commonwealth, or another state. *Id.*

[iii] Va. Code Ann. § 6.2-309, which provides that "Notwithstanding any statutory or case

law, a bank or savings institution making a loan payable in installments may impose finance charges and other charges and fees at such rates and in such amounts and manner as the borrower has agreed." Va. Code Ann. § 6.2-309(A). Importantly, this section of the Chapter preserves Article 4, entitled "Loans Exempt from Limit on Contract Rate of Interest. The section of the Chapter provides an exception to the general rule of 12% interest per year for other entities, including licensed Consumer Finance Act licensees. Va. Code Ann. § 6.2-309(B).

[iv] *See* https://legiscan.com/VA/text/SB1252/id/3084921.

[v] Senate Bill 1252 amending Va. Code Ann. § 6.2-303.

[vi] Senate Bill 1252 amending Va. Code Ann. § 6.2-301.

[vii] *See* https://www.occ.gov/news-issuances/bulletins/2024/bulletin-2024-11.html.

[viii] *See* https://www.fdic.gov/news/financial-institution-letters/2023/fil23029.html.

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