

New York Department of Financial Services Issues Proposed Rules Implementing Commercial Financing Disclosure Laws

September 30, 2021

On September 21, 2021, the State of New York Department of Financial Services (DFS) issued proposed regulations that will implement statutory requirements related to commercial financing disclosures for certain types of commercial financing transactions (the NY DFS Proposal or the Proposal).¹ The Proposal implements New York's Commercial Finance Disclosure Law which was originally enacted at the end of 2020 and then further legislatively modified in early 2021. Such modification included an increase of the law's requirements to certain covered commercial financing transactions from \$500,000 to \$2,500,000, thereby increasing its scope by five-fold.

When finalized, it is intended that the disclosures required to be provided to these "smaller"² commercial borrowers pursuant to a final rule will allow such borrowers to both better understand and to compare the cost of credit in much the same way federal law regulates such disclosures for consumers.³ As of the date of this alert, while certain federal agencies have taken the position that such agencies' authority extends to certain aspects of the provision of commercial credit, there is no federal law that directly regulates the provision or content of credit-related information to commercial customers.⁴

Much like the proposed rules still being developed by the State of California Department of Financial Protection and Innovation (CA DFPI) implementing that state's laws related to commercial disclosures,⁵ the NY DFS Proposal will require that affected commercial lenders provide specific disclosures in a prescribed format to commercial borrowers at the time a specific offer of financing is extended to the credit applicant. The Proposal contains an extensive "Definitions" section setting forth proposed interpretations for all the terms contemplated.

¹ https://www.dfs.ny.gov/system/files/documents/2021/09/pre_proposed_fs_sect600.pdf. Note that certain creditors, including banks and other insured depository institutions, are exempt from the proposed requirements.

² The NY DFS Proposal generally includes commercial credit in an amount up to \$2,500,000, calculated as an "aggregate amount that a recipient may receive under a commercial financing agreement and not the amount of any particular advance under such agreement." *Id.*

³ Regulation Z, which implements the federal Truth in Lending Act, provides that non-mortgage credit provided for personal, family or household use above \$58,300 is not subject to Regulation Z because it does not meet the regulation's threshold requirement. See <https://www.consumerfinance.gov/rules-policy/final-rules/truth-lending-regulation-z-threshold-adjustments/>

⁴ The FTC has publicly taken the position that its authority to regulate unfair and deceptive conduct in the marketplace extends to commercial transactions based upon its authority in Section 5 of the Federal Trade Commission Act. For example, a former director of the FTC's Director of the Bureau of Consumer Protection Division publicly described this authority as follows: "Unlike other federal regulators, we're not constrained by whether the transaction is for personal, family, or household purposes, that our organic statute, the FTC Act, allows us to address unfair and deceptive practices, even with respect to businesses." https://www.ftc.gov/system/files/documents/videos/strictly-business-ftc-forum-small-business-financing/ftc_strictly_business_forum_on_small_business_financing_transcript_5-8-19.pdf

⁵ <https://dfpi.ca.gov/regulations-legislation-opinions-releases/>

Types of Credit Covered

The NY DFS Proposal covers the following types of commercial credit products⁶:

- Sales-based financing;
- Closed-end financing;
- Open-end financing;
- Factoring transaction financing;
- Lease financing; and
- General asset-based financing.

Penalties

Penalties for noncompliance are significant. A civil penalty of up to \$2,000 for each individual violation may be imposed and a penalty of up to \$10,000 can be imposed for each individual violation if the commercial creditor willfully violated the law. The NY DFS Superintendent is also permitted to impose additional relief including injunctive relief.

Timing

The NY DFS Proposal states that the proposal is open for a 60-day comment period after publication in the State Register. The NY DFS release related to the issuance of the Proposal states that the “DFS is issuing the proposed regulation now in order to facilitate implementation of the CFDL in time for the January 1, 2022 deadline.”⁷

Takeaways

The NY DFS Proposal includes a number of requirements that are circular, inconsistent, and highly problematic for commercial financing companies that are attempting to develop software solutions to provide disclosures in the required format. For example, the Proposal requires that the “Amount Financed” be calculated in accordance with Appendix J of federal Regulation Z (applicable to consumer credit)⁸; however, the Proposal’s definition of the term “Amount Financed” does *not* correspond to the term’s current definition in Regulation Z. (Note that the CA DFPI commercial disclosure had a similar issue that has been subsequently corrected in the latest draft version of the rules issued by that agency).

Moreover, it appears that the statutory effective date of January 1, 2022, is unnecessarily aggressive and will be unworkable from an implementation perspective. Assuming that the comment period on the NY DFS Proposal closes in late November (60 days after publication in late September of the Proposal), it will take the agency significant time to process and evaluate the comments it will likely receive. It seems highly improbable that a final rule could be issued within 30 days of such date. Even if that were possible, that contemplates a final rule release date close to December 25 (this assumes that the NY DFS is able to issue a final rule and does not have to issue another draft proposal for further public comment, as has consistently been the case with the CA DFPI as it has published numerous proposals for public comment in an effort to implement that state’s smaller dollar commercial lending disclosure requirements).

⁶ Each term is separately defined in the Proposal.

⁷ https://www.dfs.ny.gov/reports_and_publications/press_releases/pr202109211

⁸ <https://www.consumerfinance.gov/rules-policy/regulations/1026/j/>

Even the most earnest commercial lenders with retained APR consultants and programmers cannot program software and rework loan origination policies and procedures to comply with a final rule (and thereafter adequately test what has been developed) in less than four to six months. Given the extremely abbreviated window between the likely adoption of final rule and its January 1, 2022 effective date, it seems certain that this timing “misalignment” will lead to one of two results: (a) the NY DFS will have to ignore the statutorily required effective date and delay the final rule’s implementation date, or (b) an affected creditor (or trade association) will likely take the agency to court to seek an injunction to delay the implementation based on numerous theories related to the impossibility the stated effective date creates for compliance.

Commercial lenders affected by the Proposal should immediately begin testing the affected parts of its origination process to determine both where to insert these disclosures and, more importantly, to determine the calculations necessary to create the disclosure materials required by the law.

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