Regulatory Impact Statement for the Proposed Amendment to 23 NYCRR Part 600

1. Statutory authority: Financial Services Law (or "FSL") Sections 102, 201, 202, 301, 302 and 811.

FSL § 102 sets forth the purpose and goals of the Financial Services Law including, as relevant, to "establish a modern system of regulation, rule making and adjudication" and to ensure "the prudent conduct of the providers of financial products and services, through responsible regulation and supervision."

FSL § 201 sets forth a declaration of policy for the Department of Financial Services (the "Department") and states, as relevant, that the Superintendent shall take such actions as the Superintendent believes necessary to "foster the growth of the financial industry in New York and spur state economic development through judicious regulation and vigilant supervision."

FSL § 202 establishes the Superintendent of Financial Services and provides the Superintendent with broad rights, powers, duties and discretion with respect to matters under the Financial Services Law, the Banking Law, and the Insurance Law.

FSL § 301 sets forth the powers of the Superintendent under relevant law.

FSL § 302 sets forth the power of the Superintendent to prescribe, withdraw or amend rules and regulations involving financial products and services, including in effectuating and interpreting the provisions of the Financial Services Law, the Banking Law, and the Insurance Law, and in governing the procedures to be followed in the practice of the Department.

FSL § 811 authorizes and empowers the Superintendent to promulgate such rules and regulations as may appropriate for the effective administration of FSL Sections 801-812.

2. Legislative objectives: Disclosure requirements for certain providers of commercial financing transactions are set forth in FSL Article 8, Sections 801-812.

Small businesses make up 99.8% of all New York businesses and employ four million people, or 50.2% of the private workforce. During the last financial crisis, bank loans to small businesses declined, exacerbating the

credit crunch felt by small businesses. Alternative lenders, leveraging advances in technology, jumped to fill the gap and serve the small business market, creating issues unique to small business lending. There are many federal and state laws that apply to loans originated for person, family, or household purposes. The Truth in Lending Act ("TILA") and its implementing regulation, Regulation Z, is the primary federal law regulating consumer credit. TILA requires creditors to make disclosures to borrowers regarding the cost of borrowing money over time. The intent behind TILA is to allow consumers to understand the true cost of the money they are borrowing and to facilitate easy comparison of credit terms across creditors.

The disclosures created in TILA and Regulation Z do not apply to extensions of credit primarily for a business or commercial purpose, so commercial financing providers are not required to disclose key financing terms in any standard format. FSL Article 8 seeks to create standardized disclosures for small business financings comparable to the TILA disclosures available for natural persons seeking consumer credit.

The Legislature considered it vital that business owners are afforded as much transparency as possible on how a commercial financing product will impact their business. The comprehensive disclosures required by FSL Article 8 provide business owners with the necessary information to make an informed, financially responsible decision. Standardized disclosures will also allow borrowers to compare the pricing and costs of a commercial financing among several providers.

The statute specifies four (4) types of financing (sales-based, closed-end, open-end and factoring) and also specifies the types of disclosures required. Section 807 directs the Superintendent to identify other forms of commercial financing that are subject to the statute and promulgate disclosures based on criteria listed in FSL Section 807. FSL Section 811 specifically directs the Superintendent to develop calculation methods for any metrics required in a disclosure, provide formats for disclosure forms, define and clarify key terms in the statute, and issue rules necessary to enforce the statute.

The statute expressly exempts (1) financial institutions (federal or state-chartered banks, federal or state-chartered trust companies, federal or state-chartered savings and loan associations, industrial loan companies, and federal or state-chartered credit unions), (2) lenders regulated under the federal Farm Credit Act, 12 U.S.C. Section 2001 *et. seq*., (3) commercial financing secured by real property, (4) technology service providers that only provide software and support services, (5) lenders who make no more than five applicable transactions in New York in a 12-month period, (6) individual financings exceeding $2,500,000, and (7) automobile financings.

3. Needs and benefits: The Legislature has mandated disclosures for commercial financing in amounts up to $2,500,000. The comprehensive disclosure formats and calculation methods set forth in Part 600 should provide business owners with the necessary information to make informed, financially responsible decisions about their financings. Standardized disclosures allow borrowers to compare the pricing and costs of a commercial financing among several providers.

4. Costs: The requirements of Part 600 do impose short term costs on providers of commercial financing. Providers will incur expenses to develop the disclosure forms required by Part 600 and adjust their compliance practices, computer systems and third-party contracts. After this initial adjustment period, the ongoing additional costs incurred by providers will not be significant. The Department believes the vast majority of these businesses already have the experience, resources and systems to comply with these requirements.

The Department does not expect to incur any additional expenses to implement Part 600.

5. Local government mandates: Part 600 would impose no new mandates on any county, city, town, village, school district, fire district or other special district.

6. Paperwork: Providers who offer sales-based financings and use the opt-in method of calculating APR will be required to provide the Department with annual disclosures. Otherwise, all affected providers will

be required to provide disclosure forms to prospective borrowers. It is not anticipated that providers will need additional professional services other than those used in the normal course of their business to comply with the new required disclosures.

7. Duplication: This rule does not duplicate or conflict with any existing federal rules or other legal requirements. FSL Article 8 and Part 600 are only applicable in commercial financings when the federal TILA and Regulation Z are not applicable. Lenders regulated under the federal Farm Credit Act, 12 U.S.C. Section 2001 *et. seq.*, are expressly excluded from the scope of FSL Article 8 and Part 600.

Part 600 does affect licensed lenders regulated under Article IX, Sections 340-359, of the New York Banking Law ("NYBL"). Part 600 applies to licensed lenders who make applicable commercial financing. NYBL Section 352 instructs licensees to follow TILA disclosure standards for open-end loans. These licensees should follow Part 600 standards for applicable business loans to sole proprietors.

8. Alternatives: There are no viable alternatives to this regulation. The Department is promulgating Part 600 to comply with an expressed statutory mandate in FSL Article 8.

The Department posted a draft text of this regulation on its website for 10 days to solicit comment from small businesses that might be affected. The Department received 8 comments. One commenter representing small businesses praised the proposed text and suggested additional protections for small business. Seven other comments requested revisions mainly for the benefit of financiers.

One commenter representing small businesses pointed out that FSL section 808 requires a special disclosure concerning "double dipping." "Double dipping" refers to a common practice used by financiers when doing renewals and refinancings. Lenders charge borrowers for fixed fees still outstanding and due under a prior financing when they do a renewal financing or a refinancing; they then charge fixed fees for the new financing. The Department responded to this comment by amending its disclosure formats. Industry representatives

objected to the term “double dipping,” but FSL section 808 uses this terminology and requires its use in disclosure forms.

All commenters believe a transition period for compliance is necessary after Part 600 is adopted. Financiers and brokers must see the final regulation before they can adjust their computer systems, compliance procedures, and contracts with other parties. They must train their employees on the new law. Several commenters requested a six-month period for compliance. The Department has heeded this request. Affected parties will only be required to fully conform to the disclosure requirements of Part 600 six months after the final adoption and publication of the regulation.

The Department made other changes based on comments from lending industry representatives. First, the Department modified the definition of when a specific offer is made that triggers the requirement to provide a disclosure. This change should allow for some negotiations between borrowers and lenders before disclosures are required. Second, commentors suggested the Department include the Secured Overnight Financing Rate (SOFR) as one of the acceptable rate indexes to be used in adjustable-rate financings. The Department feels this change is appropriate because the London Inter-Bank Offered Rate (LIBOR) is being phased out as a benchmark. Third, the Department clarified the definition of a “broker;” the term “broker” is now defined in terms of the substantive services they perform during the underwriting process. Finally, the Department has modified the allowed tolerances in the calculation of APRs required under Part 600.04. For most transactions, the tolerance threshold will remain 1/8 of a percent; for irregular transactions, the Department proposes a larger tolerance of 1/4 of a percent.

The Department did not feel it was wise to make additional revisions to Part 600 at this time. Some comments requested changes that were inconsistent with the letter and spirit of FSL Article 8. Other comments require further deliberation by the Department and consideration of additional comments during a full 60-day comment period.

9. Federal standards: Part 600 does not conflict with TILA or Regulation Z. It seeks to create disclosure standards applicable for business financings not otherwise covered by federal law.

10. Compliance schedule: The Department understands that financiers and brokers will need time to adjust their practices after Part 600 is adopted. Accordingly, the compliance date for Part 600 is set at six months after the date of publication of the Notice of Adoption in the State Register.

Regulatory Flexibility Analysis for Small Businesses and Local Governments for Proposed New Part 600 to 23 NYCRR

1. Effect of the rule: State Administrative Procedure Act ("SAPA") Section 102(8) defines a small business to mean "any business which is resident in this State, independently owned and operated, and employs one hundred or less individuals." This rule affects all companies regulated under Financial Services Law Article 8 equally, including regulated entities that are small businesses.

The new 23 NYCRR Part 600 will require lenders to write new disclosure forms for use in commercial financings for small businesses. All affected lenders will be required to provide disclosure forms to prospective borrowers. Lenders who do sales-based financings and use the opt-in method of calculating Annual Percentage Rate ("APR") will be required to provide the Department of Financial Services ("Department") with annual disclosures. Compliance with the new Part 600 will apply uniformly for all lenders.

To the extent any lender is a small business, it is operating in a highly regulated environment and should be adequately prepared to comply with the proposed rule. The Legislature has already extended the effective date of Financial Services Law Article 8 to give affected lenders more time to prepare for implementation of the new disclosures required.

This rule does not affect local governments.

2. Compliance requirements: The new Part 600 will require lenders to write new disclosure forms for use in commercial financings for small businesses. All affected lenders will be required to provide disclosure forms to prospective borrowers. Lenders that do sales-based financings and use the opt-in method of calculating APR will be required to provide the Department with annual disclosures.

No local government will have to undertake any reporting, recordkeeping, or other affirmative acts to comply with this rule because the rule does not apply to any local government.

3. Professional services: Lenders should not need additional professional services other than those used in the normal course of their business to comply with the new required disclosures.

No local government will need professional services to comply with this rule because the rule does not apply to any local government.

4. Compliance costs: The requirements of Part 600 impose short term costs on lenders. Lenders must incur expenses to develop the disclosure forms required by Part 600. Thereafter, the additional costs incurred by lenders will not be significant. Lenders will need to produce the required disclosure forms on a regular basis.

No local government will incur any costs to comply with this amendment because the amendment does not apply to any local government.

5. Economic and technological feasibility: Regulated entities, including those that are small businesses, should not incur significant economic or technological impact as a result of the rule.

This rule does not apply to any local government; therefore, no local government should experience any economic or technological impact as a result of the rule.

6. Minimizing adverse impact: The Department is obligated to promulgate Part 600 by Financial Services Law Article 8. There is no alternative to this regulation.

No local government should be adversely impacted by this rule because the rule does not apply to any local government.

7. Small business and local government participation: The Department complied with SAPA Section 202-b(6) by posting the proposed rule on its website for informal outreach and notifying trade organizations that represent the interests of small businesses that the proposed rule had been posted. The Department also will comply with SAPA section 202-b(6) by publishing the proposed amendment in the State Register and posting the proposed amendment on its website again.

Rural Area Flexibility Analysis for the Proposed New 23 NYCRR 600

1. Types and Estimated Numbers: The Department of Financial Services ("Department") does not have an estimate of the total number of firms affected by the regulation. The Department believes that the vast majority of lenders affected by new 23 NYCRR Part 600 already have the experience, resources and systems to comply with these requirements. Lenders located in rural areas should not be affected differently from other lenders.

2. Reporting, Recordkeeping and Other Compliance Requirements; and Professional Services: Lenders that do sales-based financings and use the opt-in method of calculating the Annual Percentage Rate ("APR") will be required to provide the Department with annual disclosures. Otherwise, all affected lenders will be required to provide disclosure forms to prospective borrowers. Compliance with the new Part 600 will apply uniformly to all lenders. Lenders located in rural areas should not need additional professional services other than those used in the normal course of their business to comply with the new required disclosures.

3. Costs: The requirements of Part 600 impose short term costs on lenders. Lenders must incur expenses to develop the disclosure forms required by Part 600. Thereafter, the additional costs incurred by lenders will not be significant. The Department believes the vast majority of these businesses already have the experience, resources and systems to comply with these requirements. The requirements of Part 600 will apply uniformly across all lenders and it is not anticipated that lenders located in rural areas will have any different costs than those located in urban or suburban areas. Lenders that specialize in agricultural loans may not experience any additional costs at all.

4. Minimizing Adverse Impacts: The requirements of Part 600 will apply uniformly across all geographic regions. The Department has determined that uniform regulatory requirements are appropriate. Rural areas will be less affected by Part 600 because most agricultural loans are effectively exempted from its

disclosure requirements by Financial Services Law Section 802(c), which expressly exempts any "lender regulated under the federal Farm Credit Act (12 U.S.C. Sec. 2001 et. Seq)."

5. Rural Area Participation: The Department has received and responded to numerous industry inquiries regarding Financial Services Law Article 8 and 23 NYCRR Part 600. To the extent that it has the discretion to do so, the Department has tailored Part 600 to address the concerns of lenders without compromising any protections for small businesses.

Statement Setting Forth the Basis for the Finding that the Proposed New 23 NYCRR 600 Will Not Have a Substantial Adverse Impact on Jobs and Employment

This amendment should not adversely impact jobs or employment opportunities in New York State. The disclosures contemplated in Part 600 of 23 NYCRR are comparable to disclosures under the federal Truth in Lending Act ("TILA") for consumer lending. TILA disclosures have never impaired the growth of consumer credit or employment at firms that supply consumer credit. Part 600 makes the terms of financing easier for small businesses to understand and compare and improves fairness and transparency in the financing process. Better financing options for borrowers should improve their business prospects, so improved disclosures might have a positive impact on small business employment.