<u>Assessment of Public Comments for the Revised Proposed New Part 600 to 23 NYCRR</u>

The New York State Department of Financial Services (the "Department") received 18 comments on proposed rule 23 NYCRR 600 ("Part 600") from providers, entities and persons representing them, and advocates for the small business community.

Some commenters are opposed to the basic purpose of the Commercial Finance Disclosure Law ("CFDL"), Financial Services Law ("FSL") sections 801-811, and accordingly are opposed to the regulation. Most commenters acknowledge the need for the rule to implement the CFDL and made comments intended to improve the regulation from their perspective. Small business advocates generally praised the Department's original proposal and sought incremental changes. Providers generally wanted more extensive revisions, particularly in sections relevant to their business niches. Most commenters addressed multiple provisions of the proposed rule and suggested numerous detailed changes.

The Department has processed and carefully considered every comment it has received and has made several revisions and clarifications to the proposal. This assessment of public comments is intended to provide an overview of the revisions and clarifications that the Department has made in response to comments, and, where applicable, the reasons for not making additional revisions or clarifications. In many instances, the Department did not make recommended revisions because it found them either unnecessary or inconsistent with the goals of the regulation.

Several commenters asked the Department to change the regulation to effectively negate provisions of the CFDL. Several commenters asked the Department to lobby for changes in the statute on their behalf. The Department cannot take such actions. The statute specifies four (4) types of financing (sales-based, closed-end, open-end and factoring) and also specifies the types of disclosures required. FSL 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 the section. 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 Department originally had proposed and now has revised Part 600 only for these purposes.

Relationship of Part 600 to Other Laws

The State of California has enacted a similar disclosure statute and its financial services regulator is actively working to create its own implementing regulation. Many commenters want the Department to make 23 NYCRR Part 600 identical to the California regulation or as consistent as possible. The Department agrees with this general aspiration. The Department has consulted with the California Department of Financial Protection and Innovation ("DFPI") regarding its commercial financing law and its draft regulations.

However, Part 600 cannot be identical to the California regulation for two reasons. First, the CFDL differs from the California statute. Second, the California regulation is a work in progress, and the Department cannot anticipate any future revisions the DFPI might make in the future.

The CFDL mandates disclosures or commercial financings comparable to those provided to consumers under the Truth in Lending Act ("TILA"). TILA and its implementing regulation, Regulation Z, are the primary federal law regulating consumer credit. Part 600 does reference TILA and Regulation Z for certain purposes. TILA requires creditors to make disclosures to borrowers regarding the cost of financing over time. The intent behind TILA is to allow consumers to understand the true cost of the money they are receiving and to facilitate easy comparison of credit terms across creditors.

One commenter requested the inclusion of a statement, found in Regulation Z (12 CFR § 1026.17(c)), that "the disclosures shall reflect the terms of the legal obligations between the parties. If any information necessary for an accurate disclosure is unknown to the provider, the provider shall make the disclosure based on the best information reasonably available at the time the disclosure is provided to the recipient, and shall state clearly that the disclosure is an estimate." However, the Department believes the regulations adequately reflect the provider's disclosure obligations. For financing other than sales-based financing, Section 600.05(k) allows providers, where estimates or assumptions are used, to base their estimates upon the best information available; in such cases, the financier must state clearly that the figures are based upon an estimate or assumption and explain those estimates/assumptions. Accordingly, the Department did not make this change.

Another commenter asked that Part 600 explicitly state that the closed-end credit annual percentage rate ("APR") calculations of 12 CFR 1026.22 do not apply to open-end credit agreements, and that rather, APRs for open-end financing should be calculated according to 12 CFR 1026.6(b)(2)(i) (which sets forth APR calculations for open-end credit agreements). However, FSL Section 803(c) explicitly requires use of 12 CFR § 1026.22 for the APR calculation for sales-based financing. Accordingly, the Department did not make this change.

Effective Date

In response to commenters requesting time to implement the new aspects of the rule, the Department is providing transition time. Section 600.25 now specifies that providers and brokers must comply with the regulation within six months after its adoption. The Department also issued a guidance on December 31, 2021 for this purpose: https://www.dfs.ny.gov/industry_guidance/regulations/proposed_fsl.

Jurisdictional Nexus

Multiple commenters requested the Department to include a jurisdictional nexus into Part 600. They asked for a narrow rule to define when the CFDL and Part 600 applies to a specific transaction. They suggested that New York law only apply when a financing recipient's business is "principally directed or managed from New York." Further, they suggested that a provider may rely upon any written representation by the recipient to determine whether it is principally directed or managed from New York in determining whether the CFDL and Part 600 apply.

The CFDL does not specify any jurisdictional nexus. The statute is silent on this point. Accordingly, the Department cannot assume that the Legislature intended to deviate from the common law of the State.

Accordingly, in response to comments, the Department proposes the new Section 600.24. A transaction is subject to the CFDL if one of the parties is principally directed or managed from New York, or the provider negotiated the commercial financing from a location in New York. The Department believes this approach is consistent with New York caselaw. Nonetheless, the Department also believes that the narrower rule suggested by commenters is necessary in cases where financing disclosure laws come into direct conflict. A financier should only deliver a disclosure once based on one set of legal requirements. Since New York and California law cannot be identical, the Department believes that a narrow and clear rule is necessary to determine which state law applies in case of conflicts. Further, multiple other states may adopt similar disclosure legislation in the future, so the possibility of actual conflict may increase over time. The Department believes the home state of the recipient of financing has the greatest interest in protecting its own businesses.

<u>Requests for Additional Exemptions</u>

Several commenters asked the Department to declare certain types of transactions to be outside the scope of the CFDL and Part 600.

Providers of factoring financing asserted that "true sales" of receivables on an irrevocable, non-recourse basis should not be considered factoring transactions subject to the CDFL. However, CFDL Section 801(a) states that a "'[f]actoring transaction' means an accounts receivable purchase transaction that includes an agreement to purchase, transfer, or sell a legally enforceable claim for payment held by a recipient for goods the recipient has supplied or services the recipient has rendered that have been ordered but for which payment has not yet been made …" The Department does not have authority to carve out an exception to this clear language.

Providers also sell their notes, financing contracts or acquired receivables, among other interests, to others by various means (sometimes known as "forward flow" transactions). These transactions are done to free up capital or for risk management purposes. One commenter requested an exemption for transactions of this nature. However, the Department believes that the CFDL has established a clear statutory definition of transactions that are subject to the CFDL, and the Department lacks authority to narrow the scope of that definition. The Department added a new Section 600.23 to set forth requirements that recipients be notified of changes in servicing of commercial financing agreements.

One commenter requested an exemption for individual loans made to entities under common control that, cumulatively, exceed the $2.5 million threshold of the CFDL. The Department agrees that single transaction in excess of $2.5 million should not become subject to the CFDL because, for corporate convenience, it is split into different, smaller financing to entities under common control. However, the Department did not wish to create a loophole that would allow a provider to evade disclosure requirements by breaking up a single financing into several small financings. Accordingly, the Department amended the definition of "recipient" to include entities subject to common control if all such recipients receive the single offer of commercial financing simultaneously.

Several commenters requested the Department to clarify how statutory exemptions affect the duties of brokers employed by exempted organizations. The commenter asserted that brokers who act on behalf of exempt organizations, such as banks, should not be required to deliver Part 600 disclosures to recipients. The Department confirms that brokers are not required to deliver disclosures when their principals are exempt under FSL Section 802. The Department does not feel it is necessary to explicitly state this exemption in the text. Part 600 makes it clear that brokers have limited duties when acting on behalf of providers.

One commenter requested removal from the definition of "broker" a person who "gathers financing application documentation or delivers the documentation to the financer; communicates financing decisions or inquiries from the financer to the recipient; or obtains the recipient's signature on financing documents" and limitation to a person who "participates in any financing negotiation; counsels or advises the recipient about financing options; participates in the preparation of any financing documents, including financing applications; [or] contacts the financer on behalf of the recipient other than to refer the recipient)". Providers of financing have an obligation to provide compliant disclosures to brokers when they provide them with a specific commercial financing offer to convey to recipients (Section 600.21). The Department believes these obligations should apply to persons involved in collecting from recipients and delivering to providers application documents, and those who communicate financing decisions to the recipient. Therefore, the Department did not remove such language from the definition of "broker."

Other commenters requested exemptions for subsidiaries and affiliates of exempted organizations, particularly for banks or their agents. However, the CFDL does not provide exemptions for subsidiaries of federally-chartered banks or foreign banks, among other exempted entities, to the disclosure requirements of Part 600. Accordingly, the Department did not make this change.

Some commenters who do factoring, sales-based financings and open-ended financings asserted that they should be exempt from disclosure requirements because they do not make "loans" to financing recipients. The CFDL applies to a broad category of "financings" and is not limited to "loans," as that term is commonly understood. Accordingly, the Department did not make this change.

Other commenters requested blanket exemptions for equipment financings and all agricultural loans. These requests are not consistent with the statute, and the Department did not make such changes.

Timing of Disclosures, Definitions and Calculations

With respect to the timing and extent of disclosure documents, the Department received numerous comments and suggestions. An advocate for small businesses opined that FSL section 810 requires the disclosure of APR calculations whenever a financier makes a quote, even at a preliminary stage. Conversely, providers complained that adapting TILA-like APR calculations to their transactions are time consuming, burdensome and sometimes misleading in terms of cost. Many providers assert they lack sufficient data required for an APR calculation early in the sales process. The Department believes that FSL Section 810 requires disclosure of APR any time an interest rate is quoted as part of a specific offer of commercial financing, but does not believe it requires an APR disclosure any time a broker, salesperson, or covered individual mentions an interest rate or financing amount during the application process, because calculating APR correctly is complex and requires consideration of much information, some of which may not be knowable until more specifics of the transaction have been finalized. For clarity, the Department revised Part 600 to include the following language: "The requirements pertaining to the statement of a rate of finance charge or a financing amount, as that term appears in Section 810 of the CFDL, shall be in effect only upon the quotation of a specific commercial financing offer." Part 600.01(f)(1).

Two commenters raised a concern that some disclosures will become inaccurate if not signed by the recipient on the date they are provided, and requested that the provider be allowed to issue updated disclosures (correct as of the date of execution) marked "Final" without requiring re-execution. The revised draft of Part 600 did not make this change. The Department believes a new disclosure should be provided if the APR thresholds have been exceeded.

One commenter requested that disclosures for amendments of commercial financings be required only when a written modification actually takes place, prior to the recipient agreeing to the changes, on the basis that modifications frequently are made to commercial financing terms and requiring redisclosures every time a modification or change is contemplated or discussed would be excessively burdensome and create confusion for the borrower. However, the Department believes that the CFDL's requirement of standardized disclosures should apply to the modification process in order for recipients to be properly informed of the proposed terms of the modification and to be able to compare that proposal to other potential financing offers.

Two commenters expressed a concern that Part 600 was unclear as to how to calculate the amount of unpaid charges and fees included in renewal financing in cases where the original financing had a fixed financing fee. The Department added a sentence stating that, in such a case, the provider shall use the pro rata portion of the finance fee based on the fraction of the original financing amount already repaid by the recipient.

The Department's initial proposal specified that providers perform calculations based upon a 30-day month and a 360-day year. The 360-day year is an old banking convention still used for commercial lending. This convention simplified calculations in the days when computers were not widely available. For consumer transaction done under TILA, a year normally has 365 days. The Department will now permit providers to choose either method as they see fit.

The Department does understand that different methods of computation lead to slightly different results. Part 600 aims to provide small business with good comparative information, but the Department recognizes that these comparisons cannot be perfect. Assumptions made about future credit advances to recipients and cash flows to providers will lead to slightly different disclosures by providers. The Department understands that the variations will depend on the nature of the financing, and sales based financing disclosures will have the greatest differences.

Multiple commenters made observations and requests concerning the characterization of various expenses, fees and charges. Such items affect the required APR calculations and required disclosure forms. One commenter observed that factors often provide various ancillary services to customers – collection, servicing, bookkeeping and other services. The commenter asserted that these costs should be excluded from an APR calculation, since those services are not a financing cost. The Department accepted this requested change.

One commenter highlighted that during the life of a financing, the recipient might incur avoidable fees and charges such as payments for waivers of default, penalties, etc. Including these potential and avoidable fees in the initial disclosures would render the disclosures inaccurate, and requiring new disclosures every time such a fee is charged would not serve the purpose of the CFDL. Accordingly, the revised Part 600 adds a statement that a "provider is not required to provide the disclosures required by the CFDL when the finance charge of an existing financing is effectively increased due to the incurrence, by the recipient, of avoidable fees and charges."

Another commenter expressed concern that Part 600 requires the disclosure of separate broker fees that are included in the amount financed (when the amount financed exceeds the proceeds of the financing to the recipient), but not disclosure of compensation paid to brokers by providers that is not charged to the recipient directly. Brokers are often compensated by providers based on the total volume of transactions the broker conducts on a periodic basis, in which case it would be impossible to correctly calculate the fee for each particular transaction when the broker's monthly or annual transaction volume is not yet known. Accordingly, the Department did not revise Part 600 to require disclosure of all funds paid to brokers in dollar terms. However, the Department added a requirement that recipients be informed whether the broker is being compensated by the provider, by the recipient, or is not being compensated, and, if compensated by the provider, then the recipient must be informed that the broker's compensation may be based upon the transaction size and profitability to the provider or if compensated by the recipient, then the recipient must be informed of the amount of the broker compensation being paid by the recipient.

Commenters and interested parties should closely compare the new proposal with the prior proposal concerning specific details.