Assessment of Public Comments for Revised Proposed 23 NYCRR 600

The New York State Department of Financial Services ("Department") received 21 comments on proposed revised rule 23 NYCRR 600 ("Part 600").

The Department has considered every comment received and has made several revisions to Part 600. This Assessment provides an overview of these revisions and, where applicable, the reasons requested revisions were not made. The Department will not address arguments previously discussed in the Assessment of Public Comments for its original or first revised proposed regulation unless the Department has changed its previous position.

(1) Comment: Numerous commenters criticized Section 600.24's application of Financial Services Law ("FSL") sections 801-812 (the "CFDL") to all financings extended from New York providers, regardless of the location of the recipient. Commenters asserted that that New York does not have a compelling interest in protecting recipients in other states and cite conflicts of law caselaw for this proposition. They also argue that an attempt by New York to impose its disclosure laws on firms doing business in other states would violate the Dormant Commerce Clause of the United States Constitution. Several commenters also pointed out that New York firms doing business in other states might face a commercial disadvantage when competing with local firms that did not face the burden and costs of compliance with the CFDL.

Response: The CFDL does not specify any jurisdictional nexus. Absent clear legislative intent to apply the CFDL to financings made to out-of-state recipients, the Department has revised Section 600.24 to apply the CFDL only where a recipient's business is principally managed or directed from the state of New York or where the recipient (if a natural person) is a legal resident of the state of New York.

(2) Comment: Multiple commenters requested exemptions for subsidiaries and affiliates of exempted organizations. A bank chartered by the Department commented that its subsidiaries were created pursuant to explicit provisions in the New York Banking Law or with the Department's explicit permission pursuant to the

New York Banking Law. The Department supervises the bank and all its subsidiaries as an integrated enterprise, and so, the bank argued, subsidiaries should not be treated differently than the parent bank. A banking trade association made similar arguments in its first comment on the original proposed text, and stated that it still believes such an exemption is prudent when commenting on the revised text.

Response: The Department has reconsidered its position and clarified that the term "financial institution" in FSL Section 801(f) includes all majority owned subsidiaries of banks and credit unions. The CFDL does not discuss subsidiaries or affiliates of exempted entities. The Department understands that banks and credit unions were exempted from the requirements of the CFDL because they are already subject to oversight. The Department believes the change in the definition of "financial institution" is consistent with the legislative intent because they are subject to consolidated oversight. Further, the subsidiaries of foreign banks, federally-chartered banks, banks chartered by other states, and all federally-chartered and state-chartered credit unions are also exempt based upon the new definition of "financial institution" stated in new Section 600.01(r). Federally-chartered and foreign bank affiliates requested this type of exemption in earlier stages of the regulatory process, and the Department wishes to treat all exempted financial institutions equally.

(3) Comment: A company licensed by the Small Business Administration ("SBA") as a Small Business Lending Company ("SBLC") asked that it be deemed a "financial institution" within the meaning of FSL Section 801(f). It argued that SBLCs offer loans under the SBA's 7(a) program and are required to make disclosures specified by the SBA. It believes an additional disclosure under Part 600 would be duplicative and possibly inconsistent. It claims regulation by the SBA is stringent enough for them to also receive an exemption.

Response: The Department will not use recently adopted policies of the SBA to define the meaning of "financial institution." The exemptions in FSL Section 802 clearly only apply to entities subject to supervision by bank regulators. The Legislature could have exempted entities subject to the SBA from the requirements of the CFDL, but did not do so.

(4) Comment: Multiple commenters strongly objected to the new Section 600.23 regarding a "notice of transfer of servicing" included in the first revised proposal. They claimed that the Department was adding a provision not authorized by the CFDL itself. They also objected that the prior notice provision required a recipient to receive notice of an assignment 15 days prior to the effective date of the transfer which, they argued, would interfere with the assignability of contracts while providing the recipients with minimal additional transparency. In the alternative, a trade association asked the Department to consider modelling any disclosure language on the provisions of Section 9-406 of the Uniform Commercial Code ("UCC").

Response: The Department accepts both these arguments and the proposed solution. The revised Section 600.23 states that a recipient, consistent with UCC section 9-406, may continue to make payments to its original obligor before receiving notice of an assignment.

(5) Comments: In its first revised proposal, the Department revised the disclosure forms to include disclosures on broker compensation. Three commenters assert that the disclosure forms the Department proposed were not authorized by the CFDL and were unworkable. These objections include the following:

(i) The purpose of the CFDL is to explain to the recipient the cost of the financing, and the disclosures do that – breaking out the broker fee adds no useful information;

(ii) Broker fees can be paid by means other than either the recipient or the financer (sometimes they are paid by both), and the proposed disclosures do not capture that nuance;

(iii) The proposed broker fee disclosure did not cover fixed fee arrangements; and

(iv) Most brokerage commissions are paid out of the funded amount, not deducted from the funded amount.

Response: The Department attempted in its first revised proposal to adjust its disclosure forms to accommodate the various types of compensation that brokers receive but it is difficult to craft forms that address all of the relevant issues. The Department has removed broker compensation from the disclosure forms entirely.

Now, Section 600.21(f) only states that providers (i.e., financers) should disclose the compensation paid to brokers in writing. This general provision does not specify a form of disclosure. Financers have the discretion to explain broking fees, in writing, so long as their disclosures are accurate.

The Department does not accept the claim that brokers cannot be covered at all by Part 600 because brokerage is not mentioned explicitly in the CFDL. The Department must interpret the term "provider" in FSL Section 801(h), and that definition includes, "a person who solicits and presents specific offers of commercial financing on behalf of a third party." That is typically what a broker does.

Further, FSL Section 811 states: "The superintendent is hereby authorized and empowered to promulgate such rules and regulations as may in the judgment of the superintendent be consistent with the purposes of this article, or appropriate for the effective administration of this article…." While FSL Section 811 enumerates four specific topics that new regulations should cover, this list is not exclusive. Brokerage compensation can cost recipients money, and even if financers provide all the brokers' compensation, the recipient should still be aware of the broker's interest in the transaction.

Accordingly, financers and brokers still have duties to observe under Section 600.21. Most of these duties fall upon the financers. Brokers mainly have a duty to deliver documents as specified in Section 600.21. Please note that the document retention provisions in Section 600.21 only apply to financers.

(6) Comment: One commenter asked the Department to clarify the "separateness" requirement in Section 600.17(c)(1) in the context of electronic disclosures by changing the wording to "separate document" and cross-referencing to Section 600.5(e). Further, this commenter requested adjustments to Section 600.5(j) and 600.18(a) to allow electronic signatures to be captured with a check box or button. The commenter generally wanted the Department to provide more flexibility in the conduct of online commerce.

Response: The Department accepted these comments. The Department revised Sections 600.5 and 600.18 concerning digital signatures. The New York Electronic Signatures and Records Act ("ESRA") recognizes that

the technology and practices of internet commerce are evolving rapidly. The Department accepts that there are many ways for a recipient to acknowledge receipt of a required disclosure and sign such a document. The Department does not seek to predict future changes in Internet commerce or prescribe rigid forms for acknowledgement and acceptance of disclosure terms. Financers should consult caselaw and interpretations of the ESRA if they have any concerns about acceptable practices for digital signatures in the future.

The Department also adjusted the "separateness" requirement in Section 600.17 to accommodate digital disclosures. A "separate document" can be a discrete digital file provided to a recipient with a series of other digital files related to a proposed financing.

(7) Comment: An attorney for clients who provide "floor plan financing" for auto dealers commented that his clients want to use their own customized Truth in Lending Act ("TILA") forms as a substitute for the forms mandated by Part 600. The attorney stated that his clients presently provide TILA disclosures to all borrowers, individual or commercial, even if not required by TILA, for the sake of simplicity and consistency. The attorney requested a change in 600.1(m) to give his clients this option. A trade association also made the same comment.

Response: The Department cannot accept this comment. While the CDFL does not apply to transactions covered by TILA, the CFDL does not authorize the Department to exempt transactions not covered by TILA from the provisions of the CFDL because they use TILA-compliant disclosures. The CFDL mandates a consistent set of disclosures for non-bank financers providing financing to small businesses. Allowing providers to choose which forms to use for such transactions would defeat much of the purpose of the CFDL.

(8) Comment: A trade association asked the Department to redefine the term "factoring transaction" set forth in FSL Section 801(a) to include only transactions in which there is an actual advance of funds to the recipient. The association claims that factors often only provide ledgering and collection services and do not advance any money to the recipient.

Response: The Department will not make the requested change because it is inconsistent with the text of the statute.

If a vendor is truly not advancing funds to a recipient, then it is merely a professional service provider not subject to the CFDL. However, if the provider is ultimately providing financing in a related transaction, then it is doing more than just providing services for a fee. The financing component is still subject to the CFDL.

(9) Comment: In its first revised proposed regulation, the Department clarified the timing of the obligation to provide disclosures based on APR. The Department accepted that APR would be impossible to calculate unless and until the provider had obtained specific information about the borrower and the proposed terms, so it revised Part 600 to make clear that providers only had to include the statutorily required APR disclosure when the provider quotes a specific offer of commercial financing. A small business advocacy organization requested that Part 600 should explicitly require APR to be stated when any rates are stated *after* there has already been a quotation of a specific commercial financing offer.

Response: This change is consistent with the intent of providing clear disclosures to recipients. The Department adjusted Section 600.1(f) and Section 600.3(b) accordingly.

Commenters and interested parties should closely compare the adopted text with the prior revised proposal concerning specific details.