Secured Finance Network

December 6, 2020

Via E-Mail

Office of Assemblyman Kenneth Zebrowski
Attn: Chris Bresnan

Re: Request for Amendment to AB.10118A and SB5470 ("the Statute")

Dear Chris:

On behalf of the Secured Finance Network ("SFNet"), thank you for the opportunity to offer the following amended terms to the above referenced Statute for consideration. If adopted, these recommendations would address the primary concerns we have discussed and outlined in previous correspondence and create a framework for working with DFS on a pragmatic implementation plan.

The Secured Finance Network remains supportive of the policy objectives underlying the Statute, namely, providing helpful information to small businesses in order to assist them in making an informed decision on which financing product is right for them. That being said, the current wording of the Statute, in certain limited respects, creates uncertainty in terms of compliance, and it creates the risk of "sand in the gears" in facilitating transparent disclosure on an "apples to apples" basis, when different types of financing are being considered by a small business borrower. There is a plethora of financing products made available to small businesses, and each of the categories of potential financing types addressed in the Statute comprises numerous subcategories of financing with different terms and structures.

Set forth below are five sections of the Statute that SFNet feels should be refined, with discrete "tweaks", in order to provide a more flexible, and less mechanical, approach for achieving the Statute's policy objectives within the current construct. We believe these proposed refinements would facilitate more transparent disclosure to borrowers and help achieve the Statute's policy objectives.

1. $500,000 exemptive threshold

Section 802(g) presently reads:

Section § 802. **Exemptions**. This article shall not apply to, and shall not place any additional requirements or obligations upon, any of the following:

* * *

(g) an individual commercial financing transaction in an amount over five hundred thousand dollars.

Commentary

This exemptive relief is easy to apply to a closed-end, or term loan, being offered to a small business. But other categories of financing, such as an open-end line of credit or a factoring facility, often contemplate a series of regular financing transactions, each of which may be less than $500,000, but which may involve an aggregate amount outstanding at any one time well in excess of $500,000. Therefore, we believe the sized-based exemptive provision should look at the size of the offered facility, rather than the permitted size of any particular financing transaction under such facility (minimum draws under a $1 million facility could be as low as $25,000). The suggested changes below reflect that.

Proposed alternative language

Section § 802. **Exemptions**. This article shall not apply to, and shall not place any additional requirements or obligations upon, any of the following:

* * *

(g) ~~an individual~~ a bona fide offer for a commercial financing ~~transaction~~ facility in an amount over five hundred thousand dollars.

2. Calculation of APR in open-end facilities

Section 805(c) presently reads:

§ 805. **Open-end commercial financing disclosure requirements**. A provider, subject to this article, shall provide the following disclosures to a recipient at the time of extending a specific offer for open-end financing according to formatting prescribed by the superintendent:

* * *

(c) The annual percentage rate, using only the words annual percentage rate or the abbreviation "APR", expressed as a nominal yearly rate, inclusive of any fees and finance charges that cannot be avoided by a recipient, and calculated in accordance with the federal Truth in Lending Act, Regulation Z, 12 C.F.R. § 1026.22 and based on the maximum amount of credit available to the recipient and the term resulting from making the minimum required payments term as disclosed.

Commentary

In underwriting a proposed open-end commercial financing facility for a small business, the provider will evaluate the receivables currently held by, and expected to be generated by, the recipient over the life of the facility. The recipient may draw down under the facility on a fluctuating basis, including based on its seasonal liquidity needs. To assume maximum utilization of an open-end line of credit inappropriately overstates the aggregate finance charge the recipient may bear, and confusingly makes such line of credit offering seem artificially expensive relative to other financing alternatives that actually may be more expensive. The changes shown below attempt to mitigate this potential anomaly.

<u>Proposed alternative language</u>

§ 805. <u>Open-end commercial financing disclosure requirements</u>. A provider, subject to this article, shall provide the following disclosures to a recipient at the time of extending a specific offer for open-end financing according to formatting prescribed by the superintendent:

* * *

(c) The annual percentage rate, using only the words annual percentage rate or the abbreviation "APR", expressed as a nominal yearly rate, inclusive of any fees and finance charges that cannot be avoided by a recipient, and calculated in accordance with the federal Truth in Lending Act, Regulation Z, 12 C.F.R. § 1026.22 and based on the ~~maximum~~ amount of credit ~~available~~ <u>reasonably expected by the provider to be made available</u> to the recipient<u>,</u> and ~~the term resulting from~~<u>based on the recipient</u> making the minimum required payments ~~term~~ as disclosed.

3. <u>Calculation of APR in factoring facilities</u>

Section 806(c) presently reads:

§ 806. <u>Factoring transactions disclosure requirements</u>. A provider, subject to this article, shall provide the following disclosures to a recipient at the time of extending a specific offer for a factoring transaction according to formatting prescribed by the superintendent:

* * *

(c) The estimated annual percentage rate, using that term, calculated according to the federal Truth in Lending Act, Regulation Z, 12 C.F.R. § 1026 Appendix J, as a "single advance, single payment transaction". To calculate the estimated annual percentage rate, the purchase amount is considered the financing amount, the purchase amount minus the finance charge is considered the payment amount, and the term is established by the payment due date of the receivables. As an alternate method of establishing the term, the provider may estimate the term for a factoring transaction as the average payment period, its historical data over a period not to exceed the previous twelve months, concerning payment invoices paid by the party owing the accounts receivable in question.

<u>Commentary</u>

Factoring facilities generally contemplate an ongoing purchase of the receivables generated by the borrower/merchant. The right way to calculate APR, from such borrower/merchant's perspective, is to take into account the "days to pay" being assumed by the provider. That assumption will imply the amount of discount charged to the borrower in connection with the purchased receivables, which yields the finance charge and the APR being absorbed by the borrower. The changes suggested below are intended to result in better disclosure to the small business borrower.

Proposed alternative language

§ 806. <u>Factoring transactions disclosure requirements</u>. A provider, subject to this article, shall provide the following disclosures to a recipient at the time of extending a specific offer for a factoring transaction according to formatting prescribed by the superintendent:

* * *

(c) The estimated annual percentage rate, using that term, calculated according to the federal Truth in Lending Act, Regulation Z, 12 C.F.R. § 1026 Appendix J, as a "single advance, single payment transaction". To calculate the estimated annual percentage rate, the purchase amount is considered the financing amount, the purchase amount minus the finance charge is considered the payment amount, and the term is <u>based on the duration of the facility. With respect to such purchased receivables, the provider may estimate days to pay based on reasonable assumption</u>s<u>, including</u> ~~established by the payment due date of the receivables. As an alternate method of establishing the term, the provider may estimate the term for a factoring transaction as the average payment period, its~~ historical data over a period not to exceed the previous twelve months, concerning payment invoices paid by the ~~party~~ <u>parties</u> owing the accounts receivable in question.

4. <u>Definition of finance charges</u>

Section 801(e)'s definition of finance charges currently reads:

(e) "Finance charge" means the cost of financing as a dollar amount. It includes any charge payable directly or indirectly by the recipient and imposed directly or indirectly by the provider as an incident to or a condition of the extension of financing. It includes all charges that would be included under 12 C.F.R. part 1026.4 as if the transaction were subject to 12 C.F.R. part 1026.4. In addition, the finance charge shall include any charges as determined by the superintendent. For the purposes of an open-end financing, the finance charge shall assume the maximum amount of credit available to the recipient, in each case, is drawn and held for the duration of the term or draw period. For the purposes of a factoring transaction, the finance charge includes the discount taken on the face value of the accounts receivable.

Commentary

In order to achieve "apples to apples" disclosure, the aggregate amount of "finance charges" called for under the Statute should be based on the reasonably assumed utilization of the relevant open-end facility.

Proposed alternative language

(e) "Finance charge" means the cost of financing as a dollar amount. It includes any charge payable directly or indirectly by the recipient and imposed directly or indirectly by the provider as an incident to or a condition of the extension of financing. It includes all charges that would be included under 12 C.F.R. part 1026.4 as if the transaction were subject to 12 C.F.R. part 1026.4. In addition, the finance charge shall include any charges as determined by the superintendent. For the purposes of an open-end financing, the finance charge shall assume the ~~maximum~~ amount of credit <u>assumed to be made</u> available to the recipient<u>, consistent with the disclosure made pursuant to Section 805(c),</u> in each case, is drawn and held for the duration of the term or draw period<u>, consistent with the assumptions utilized under such Section 805(c) disclosure</u>. For the purposes of a factoring transaction, the finance charge includes the discount taken on the face value of the accounts receivable.

5. **Safe Harbor**

In addition, we would like to reiterate our request that you provide, either through additional legislative action or by the enactment of regulations, a safe harbor for providers of commercial loans to small business which insulates the providers from liability (through litigation or otherwise) if they attempt to comply with the Disclosure Requirements in good faith. This would be very similar to safe harbors contained in the Federal Truth-In-Lending Act for consumer lending disclosures. Specifically see 15 U.S.C. § 1640(b) and 15 U.S.C. § 1640(c). The safe harbor is necessary because many of the providers of commercial loans to small businesses are small businesses themselves and can't absorb the cost of litigating against a plaintiff bar in New York, which will see the Disclosure Requirements as creating a potential cause of action for them and their clients. Once the plaintiff's bar becomes active in seeking damages from the providers of loans to small businesses, it will be a matter of time before many of the providers, which are small businesses themselves, go out of business, impacting the availability of credit to small businesses in New York.

SFNet remains committed to working toward a practical solution to meeting the Statute's objectives and specifications. I am available to discuss any of these points at your convenience.

Sincerely,

Richard Gumbrecht
Chief Executive Officer
Secured Finance Network

cc. Christopher Duryea cduryea@statewidepublicaffairs.com

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