Secured Finance Network

November 17, 2021

TO: The Department of Financial Services of the State of New York
Attn: George Bogdan, Esq., Department of Financial Services, One State Street, 20th Floor, New York, NY 10004

RE: Comments to the Proposed Regulations for the Implementation of New York State's Commercial Finance Disclosure Law ("CFDL")

The Secured Finance Network, Inc. ("SFNet") www.sfnet.com is the international trade association, founded in 1944, representing the asset-based lending, factoring, trade and supply chain finance industries, with over 280 member organizations throughout the State of New York, the U.S., Canada and around the world. As we have previously communicated to the Department of Financial Services ("DFS"), SFNet and its membership are supportive of providing as much information as possible to small businesses in order to assist them in making as an informed decision as possible as to which financing products or proposals are best suit for them.

Nevertheless, SFNet and its members strongly object to some of the provisions of the proposed regulations (23NYCRR 600) ("Proposed Regulations") and urge DFS to take our comments and suggested solutions into account when finalizing these Proposed Regulations. Although the CFDL and the Proposed Regulations have implications with respect to many forms of financial products provided by our members, we specifically direct you to the implications with regard to factoring and asset based lending transactions.

Postponement of Effective Date of CFDL

As a predicate to these comments SFNet believes that the effective date of the CFDL should be extended to a date that is six months after the adoption by DFS of the final regulations to the CFDL.

This extension is necessary as currently the specific offers made by our members to their proposed borrowers are not compliant with the proposed regulations and our members need time to change their business practices in order to adopt a disclosure grid which complies with the proposed regulations. As an example the factoring disclosure grid set forth in the Proposed Regulations has over twenty specific disclosures. It will take time for our industry to both gather the information necessary for these disclosures and present them in the manner prescribed by the Proposed Regulations.

Calculation of APR

As the calculation of the annual percentage rate ("APR") is in SFNet's opinion the most significant, as well as, the most difficult of the disclosures required by the Proposed Regulation; SFNet using a hypothetical discount factoring transaction as its initial attempt at trying to calculate APR in accordance with the Proposed Regulations has spent a significant amount of time and resources trying to come up with a precise calculation of APR. Needless to say we found it extremely difficult to follow the definitions and methodology of a consumer disclosure statute (the federal Truth in Lending Act, Regulation Z, 12 C.F.R. Sec. 1026) which in turn requires a "closed end" calculation of APR (Appendix J to Part 1026) for an open ended commercial transaction such as factoring.

Enclosed is an example of what we believe to be a typical discount factoring transaction. We have made the various assumptions permitted by the Proposed Regulation and have calculated a precise APR. We would welcome the input of the DFS as to whether we have accurately and correctly calculated the APR and if not pointing out the correct manner in which to make the proper calculation.

Servicing Fees

Certain factors charge the recipient separately for the servicing of the recipients accounts and for the extension of credit as opposed to a single fee charged by other factors, such as discount factors which charge a single fee for both the discounting and servicing (See the APR example annexed to this letter). Specifically, these factors charge one fee for servicing, including the ledgering of the recipient's accounts, credit investigation and collection services and different and wholly separate fee if there is an extension of credit by the factor.

We read Section 1026.4 (b) (2) of Regulation Z of the Truth in Lending Act which governs the calculation of APR for purposes of the CFDL and the Proposed regulations to exclude these servicing fees from the calculation of the Finance Charge and therefore from the APR calculation as these fees are not incident to a condition of the extension of credit. SFNet seeks clarification on this interpretation.

Post Transaction Disclosures

Proposed Regulation Section 600.01 (a)(5)(ii) Definitions provides that disclosure will be required subsequent to the consummation of the commercial financing contract if the contract is "changed" and the resulting change would increase the finance charge.

Factoring and asset-based credit facilities are designed to provide working capital for the recipient and therefore have to adapt to the working capital needs and fluctuations of the recipient. Because

of the need to have the ability to adapt, "changes" to these financing arrangements may occur often during the term of the financing. Requiring the factors and asset-based lenders to re-disclose as required by the Proposed Regulations will be burdensome to the financing provider and create confusion for the recipient. For example, a temporary need for additional capital under the financing contract may result in the recipient requesting that the provider increase its lending to provide this additional capital. In that situation, the loan documents/factoring agreement may or may not need to be amended and the provider may charge an immaterial accommodation or amendment fee. However, in such a situation the recipient most likely will not be looking to multiple sources of financing to compare the best product available and therefore a re-disclosure does not provide any useful information for the borrower to compare against other financings.

SFNet understands that the public policy behind the CFDL is to provide information to small businesses so that these small businesses may make an informed decisions on the types of financing available to them. However, the requirement for re-disclosure for only a minor or temporary change in a single term of the loan document or factoring agreement without additional parameters does not in our opinion comport with this public policy.

We therefore propose several alternatives in which the re-disclosure requirement may be tailored to provide more useful information to the recipient.

(1) Changes in Writing. Generally, accommodations made to the recipient during the "life" of the finance or factoring transaction are documented in writing when they are material changes to the financing or factoring transaction. Limiting the re-disclosure requirement to written changes to the finance or factoring documents would make the re-disclosure requirement more meaningful to the recipient as it would capture material changes to the financing.

(2) Exclusion for Ordinary Course Changes. As discussed above, all small businesses will have ebbs and flows and financing provided to such businesses will have to adapt to these changes. There will be ordinary course modifications to a factoring facility or asset based facility which should not trigger a re-disclosure as these changes could happen often and create a burden on the provider and confuse a small business at a time when the small business is not looking for new financing or the ability to compare one financing product against another product. Furthermore, the potential time delay in providing these disclosures could worsen a small business' situation as circumstances often arise in the "life" of a financing that require almost immediate action on the part of the provider and small business to address the circumstance or risk worsening the business' situation. We request an exclusion for re-disclosures related to changes in the financing if the changes are in the ordinary course of business.

(3) Material Changes. Similar to the above suggestions, a materiality threshold would help limit confusion as frequent (sometimes daily) changes to the financing which do not result in a material change to the financing charge would not need to be disclosed even if increased the cost of the financing. We request that DFS strongly consider limiting the requirement to re-disclose to changes which materially increase the APR resulting from such changes greater than a certain percentage to be determined by DFS.

(4) Excluded Avoidable Fees and Expenses. During the "life" of a financing, there are many instances in which additional fees and expenses may be charged to the recipient due to the

actions of the recipient. For example, the recipient may fail to comply with covenants set forth in the financing documents and request that its failure by waived by the provider. In such situations, the provider may charge a waiver or amendment fee to obtain credit approval and document the waiver. Such fees and expenses could have been avoided by the recipient by simply complying with the terms of the contract. In this instance, a re-disclosure is unnecessary and we believe not in line with the public policy of the CFDL. We request that an exception be included in the Proposed Regulations for re-disclosure due to an increase in the financing charge due to the charging of avoidable fees that the recipient fail to avoid.

Finally, many of the providers lending to small businesses are themselves small businesses and an open-ended requirement to re-disclose changes to a financing transaction creates a potential material burden on these small business resulting in operational challenges for the smaller providers. We would hope that the regulations would protect all small businesses and not one group of small businesses to the detriment of other small businesses.

Non-Borrowing Factoring Facilities

There are factoring transactions that are "non-borrowing" meaning that the provider does not lend or advance any funds against the recipient's accounts receivable. The trade terminology for these type of factoring transactions is sometimes referred to as "collection factoring". In these type of transactions there is no credit extension to the factored client and thus there is a $ 0 "Approved Advance Limit".

In this type of transactions a factoring fee is charged to the recipient as consideration for invoice management or "back office" services which typically include ledgering services, credit risk assessment services in respect of the client's customers to whom goods are being sold or service are being rendered and collection services relating to pursing payment from account debtors, however, no funds are being advanced by the factor against the accounts receivables.

Without a change to Proposed Regulation 600.19, the factor engaged in collection factoring would still be required because the Approved Advance Limit would be less than $2,500,000 to make the various disclosures required by the Proposed Regulation. SFNet believes that this is not consistent with the policy of the CFDL or the Proposed Regulations. To address this inconsistency Section 600.19 (c)(1) should be revised as follows (added language underlined):

(1) Use the approved advance limit, if the transition meets all of the following requirements, except with respect to a factoring transaction where the Approved Advance Limit is $0 in which case such factoring transaction shall not be subject to these regulations.

Non-Recourse Factoring

SFNet requests that non-recourse factors be excluded from the disclosure requirements of the CFDL and the Proposed Regulations.

In a non-recourse factoring transaction the recipient sells one or more of its accounts to the factor who assumes the full credit risk and must pay the recipient the full contractual purchase price for each such account purchased without the right of charge back if the account does not collect in full

on a timely basis due solely to the post purchase occurrence of a credit risk event previously assumed by the factor.

This transaction represents a sale of the small business owner's accounts for a fee and is neither an extension of credit or an advance and therefore should be excluded from the reach of the proposed regulations.

Therefore, to exclude non-recourse factoring from the Proposed Regulations Section 600.19 (c) (1) should be revised as follows (add language underlined):

(1) Use the approved advance limit if the transaction meets all of the following requirement, except with respect to factoring transactions where the factor purchases the recipient's accounts on a non-recourse basis in which case such factoring transaction shall not be subject to these regulations.

Affiliated Recipients

Commercial financings are often provided to related recipients or co-recipients. The test as to whether the disclosure requirements applies should be at the aggregate level for recipients related by common ownership not at the individual recipient level. For example, assume the Approved Advance Limit for one recipient is $2,600,000 and for a related recipient the approved advance limit is $200,000. Under our interpretation of the Proposed Regulations the first recipient would not need to be provide the disclosure but the second would. The proposed change would eliminate the requirement for the second recipient, which is appropriate from a policy standpoint given that the two recipients in this example are related by common owners and the CFDL and the Proposed Regulations does not require the disclosure for the recipient that has the larger Approved Advance Limit. Thus the protections afforded by the disclosure are not need for the second recipient. Therefore, Section 600.01(25) of the Proposed Regulations should be revised by adding the following at the end of such subparagraph "Recipient" shall mean and be interpreted as to any recipient (considered the "first recipient") to include any other recipient that controls, is controlled by or is under common control with the first recipient".

Safe Harbor

SFNet appreciates that the Proposed Regulations at Sec. 600.04 (1) and (2) Allowed Tolerances provides the asset based lender or factor with a limited margin of error for inaccurately disclosing the APR being charged by the provider. However, because of the numerous estimates and assumptions that are required to be provided for the APR calculation even the most diligent attempts at calculating the APR could easily result in a margin of error greater than the tolerance level provided by this section.

SFNet also recognizes and appreciates that the Proposed Regulations also provides for a 60 day grace period to correct the provider's prior disclosures upon discovery by the provider of what is referred to in the Proposed Regulations as an "inadvertent" error, assuming the "inadvertent" error, which term is undefined by the Proposed Regulations, is discovered prior to any action being brought against the provider.

SFNet believes that these saving clauses while helpful do not adequately insulate or protect the provider. Therefore, SFNet requests the following changes to the Proposed Regulations:

(1) Include in Section 600.04 (2)(b) a safe harbor for providers of commercial financing to small businesses who inaccurately calculate APR provided the calculation is made in good faith. This would be very similar to safe harbor contained in the Federal Truth-In Lending Act for consumer lending disclosures (see 15 U.S.C. Sec. 1640(b) and 15 U.S.C. Sec. 1640(c)); and

(2) Provide that the APR calculation disclosed by the provider shall not serve as either a basis for any claim against the provider or evidence of criminal or civil usury.

Jurisdiction

SFNet believes that the Proposed Regulations should clarify that when the Proposed Regulations refer to a "recipient" this "recipient" must be an entity with its principal place of business in New York State for the Proposed Regulations to apply.

Definition of Finance Charges

One of the key components necessary to calculate the APR disclosure for a factoring transaction is the Finance Charge (see Section 600.02 (a)(iii) Definition of Finance Charge and Section 600.03 Annual Percentage Rate Disclosure) of the Proposed Regulations. However, these definitions differ from and do not cross-reference the definition of Finance Charge at Section 806 of the CFDL and neither reference the Factoring Fee defined at Section 600.01 (35) (b) (c) Definitions of the Proposed Regulations. SFNet believes that these definitions must be clarified.

Thank you for the opportunity to provide our comments on the proposed regulations. We look forward to further discussions regarding these important considerations.

Respectfully,

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Chief Executive Officer
Secured Finance Network