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Compliance Guidelines for the New York Commercial Finance Disclosure Law (CFDL)

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FAQs for New York CFDL Legislation

- The Commercial Finance Disclosure Law (CFDL) recently enacted legislation with a compliance deadline of Aug. 1, 2023, will affect non-bank commercial lenders making small business loans in New York State of up to $2.5 million.
- The CFDL requires providers of “specific offers of commercial finance” to provide written disclosures at the time the offer is extended, similar to those made in residential Truth in Lending transactions. Given the complexity and the penalties associated with non-compliance, including civil penalties and potential restitution for known violations, entities subject to the CFDL should commence compliance preparations as soon as feasible.

What is CFDL?

The CFDL (found in Article 8, Sections 801 to 811 of the New York Financial Services Law) sets forth numerous disclosure requirements to introduce uniformity and transparency, with a goal of standardizing small business lending and enhancing borrower awareness. Transactions already compliant with the federal Truth in Lending Act (“TILA”) and those exceeding $2.5 million are free from CFDL stipulations.

Will I be affected? If not, who will?

The law primarily targets commercial financing transactions involving residents of New York State and entities managed or directed principally from within the State of New York, with the term "providers" including direct lenders, intermediaries, and brokers offering financing services on behalf of third parties.

In addition, the CFDL does not apply to a range of entities termed "financial institutions," encompassing federally and state-chartered banks and credit unions, savings banks, trust companies, and their majority-owned subsidiaries. Notably, this exemption does not explicitly cover non-subsidiary affiliates of banks, and fintech companies that operate commercial lending platforms.

What are the requirements of CFDL? How can I comply?

The New York Department of Financial Services (DFS) has provided specific instructions on compliance. The DFS regulations stipulate providers must determine whether a loan is "commercial" and may rely on a recipient's representation to make that determination.[i] Loan proceeds that will not be used primarily for *personal, family*, or *household purposes* are now all subject to CFDL. If CFDL is applicable, providers must furnish standardized TILA consumer-like detailed disclosures at the time a financing offer is extended. An offer is defined as "a written communication to a recipient, based upon information from, or about, the recipient, of a:

- periodic payment amount, irregular payment amount, or financing amount, and
- any rate, price, or cost of financing (including, without limitation, any total repayment amount), in connection with a commercial financing."[ii]

The CFDL covers a variety of financing vehicles, including commercial sales-based financing,[iii] factoring transactions,[iv] asset-based lending transactions,[v] and certain lease financing transactions.[vi] The operational definitions of "open-end financing"[vii] and "closed-end financing"[viii] as used in the CFDL are similar to the definitions of those terms in TILA, Regulation Z, and their regulations. The rest of the commercial financing covered have no definitional analogs within TILA, as they were not the type of financing that TILA was designed to cover.

How can I determine if my asset-based lending and factoring transaction offers are equal to $2.5 million or less? If they are more than $2.5 million, what do I need to do?

There are also specific instructions regarding the calculation of the $2,500,000 disclosure threshold to determine if a CFDL exemption applies. To demonstrate that an offer is not equal to or less than $2,500,000, providers must provide both an agreement that describes conditions and general terms of the commercial financing transaction with a credit limit that was approved to exceed $2,500,000 and an agreement in writing stating that an amount in excess of $2,500,000 is reasonably expected to be advanced to the recipient. This kind of written agreement must be entered into before executing the agreement. Additionally, it must be entered before making any amendments to agreements that were entered into before the effective date, as well as before amending consummated financing agreements where the approved credit limits are being increased to more than $2,500,000. All providers should be prepared to include a short section in their agreements to clarify to recipients the transaction is considered exempt from the CFDL. If providers do not make these written agreements with their recipients, the offer will be subject to the disclosure requirements of the CFDL, including a four-year document retention requirement, as the transaction will be considered less than or equal to $2,500,000. [ix]

What time do I have to provide these disclosures, and what must they contain?

The standardized disclosures must be provided at the point of extending a specific financing offer and contain key terms such as the amount financed, finance charge (total and itemized), Annual Percentage Rate (APR), loan terms, total repayment amounts, amount and frequency of payments and descriptions of collateral requirements or security interests, as well as any potential fees and charges. Providers must now give a recipient, including their agents and brokers, a document labeled "OFFER SUMMARY." The disclosure of financial terms must follow the CFDL requirements, and "specific offers" that are quoted to recipients are binding on the provider.[x]

This effectively means that the delivery of a detailed commercial loan offer, if accepted by the

recipient, will then trigger the disclosure requirement by the CFDL. If there are multiple specific offers being extended, this requirement will be triggered when the recipient chooses one option and the disclosures must pertain to that selected option.[xi] Providers are prohibited from continuing further with the financial transaction application until the recipient's written acknowledgement is received.[xii] Specific components of the Offer Summary include APR, "amount financed," and "recipient's funds."

How can I determine APR?

APR should be "determined in accordance with either the United States Rule method or the actuarial method" as set forth in Appendix J of Regulation Z.[xiii] The APR must include all "finance charges"[xiv] as defined by Regulation Z (if it is applicable), as well as other specified charges, unless it would cause the charge to be counted twice, depending on if the transaction is an accounts receivable purchase transaction that is or is not a factoring transaction or a lease financing transaction.[xv] For commercial open-end financing, providers who are calculating APR must assume the recipient draws down the entire credit limit at origination, will make no subsequent draws, and will make minimum on-time payments according to the contract.[xvi] The APR that is disclosed at the time of extending a specific offer must be "accurate" considering the APR tolerances promulgated within the CFDL or should not be higher than 2.5% lower than the actual APR.[xvii]

There are also several category-based rules, such as for those who fall under sales-based financing. APR should be calculated by sales-based financing providers using the "historical method" or "opt-in method" based on projected sales volume, which may be the "average monthly income estimate" or "internal estimated sales projection" utilizing TILA and Regulation Z methods and definitions.[xviii]

What about the Amount Financed & Recipient Funds?

Depending on the type of commercial financing, the term "amount financed" differs slightly in definition, in which case providers will need to consult the applicable section of the regulation pertaining to the type of financing transaction.[xix] The regulations also stipulate that finance charges in this category should be calculated so that fees and charges that are involved should be excluded, and not imposed as incidents of credit. "Recipient funds" are defined by the regulation as "the net amount to be given directly to the recipient" but does not include any funds that are paid to third parties, which include brokers, or any amounts that are financed to pay off other amounts that may be owed by a recipient, that the provider is aware of at the time the disclosure is given.[xx] Providers are also mandated to ensure third-party disclosures align with compliance requirements, and failure to adhere to these standards could result in civil penalties.

Providers also must supply a separate document along with the Offer Summary, called the "Itemization of Amount Financed," for a financing transaction when the "amount financed" (typically referring to credit limit or loan amount)[xxi] exceeds the recipient's funds (the net amount that is given to a recipient after all payments on a prior loan or to third parties).[xxii]

Unfortunately, there are no model forms for the Offer Summary that include a safe harbor from any liability. However, there are individual lists including specific formatting and other informational requirements for sale-based financing (sometimes including asset-based lending if meeting the definitional requirements of sales-based financing),[xxiii] closed-end financing that does not meet definitional requirements of lease financing or sales-based financing,[xxiv] factoring transactions,[xxv] lease-financing transactions,[xxvi] commercial open-end financing,[xxvii] general asset-based lending transactions,[xxviii] and any other commercial financing transactions.[xxix]

What happens if I don’t comply?

There are also reporting requirements that stipulate details of the duties of financers and brokers who are involved in commercial financing. The regulations prescribe a process by which certain providers that are calculating APR must report their data to the Superintendent of the New York Department of Financial Services to determine if any deviations between actual retrospective APRs and those that were estimated are “reasonable.”

Under the CFDL, the Department of Financial Services (DFS) retains the authority to impose hefty civil penalties on providers for violations with a maximum fine of $2,000 per violation or $10,000 for intentional violations. Notably, this includes injunctions that may be ordered against providers who are found to have knowingly violated the law. However, the CFDL does allow providers to remedy "bona fide errors" by carrying out necessary corrections within 60 days of discovery to avoid liability. It also provides a range of tolerances within which a disclosed APR can be deemed “accurate” under the Regulation.

How do I Implement Compliance Measures?

Compliance includes a thorough review of current disclosure documents and the development of internal protocols to ensure the consistent incorporation of the requisite information in every financing offer. Compliance systems should be regularly updated to reflect CFDL requirements and emerging changes in the law to mitigate legal and financial risk.

Certain responsibilities are placed on brokers, providers, and financers when dealing with brokered transactions. One example of these responsibilities for providers may include presenting a specific commercial financing offer to a broker, providing the broker with a copy of an Offer Summary, and Itemization of Amount Financed, if applicable.

For brokers, upon receiving the disclosure and before extending the specific commercial financing offer to a recipient, they must either share the disclosures with the recipient without making any changes, or they must receive confirmation from the provider that the disclosures have been extended to the recipient.

The providers must thus implement procedures reasonably designed to make sure each recipient receives the disclosures on or before the time the broker presents them to the recipient with a specific commercial financing offer. Providers also have a responsibility to notify recipients in writing about how the broker will be paid for their role in the transaction.[xxx]

How is this Affecting State and Federal Regulatory Landscape?

The federal landscape is shifting, with the Consumer Financial Protection Bureau (CFPB) broadening its oversight of commercial financing. The CFPB's newly implemented rule, based on a directive in the Dodd-Frank Act, section 1071, requires commercial lenders to collect and report detailed demographic and financial data related to applications and originations. This rule applies to "covered financial institutions," defined by volume rather than category, encompassing many lenders. This heightened regulatory scrutiny increases the potential liabilities for those in the commercial lending space.

In the face of escalating regulatory scrutiny and evolving compliance landscapes, legal counsel, due

diligence, and vigilance are vital for entities subject to the CFDL.

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- **Footnotes**

[i] N.Y. Fin. Services. Law § 801(b).

[ii] 23 NYCRR § 600.1(ai).

[iii]N.Y. Fin. Services. Law § 801(j); “Sales-based financing” is defined as any “transaction that is repaid by the recipient to the provider, over time, as a percentage of sales or revenue, in which the payment amount may increase or decrease according to the volume of sales made or revenue received by the recipient. Sales-based financing also includes a true-up mechanism where the financing is repaid as a fixed payment but provides for a reconciliation process that adjusts the payment to an amount that is a percentage of sales or revenue.

[iv] N.Y. Fin. Services. Law § 801(a); “Factoring transactions” according to CFDL are defined as accounts receivable purchase transactions.

[v] 23 NYCRR § 600.0(e); “Asset- based lending transactions” covers "advances . . . made from time to time contingent on the recipient forwarding payments.received from one or more third parties for goods that the recipient has supplied or services the recipient has rendered to that third party or parties."

[vi] “Lease financing” under the regulations means “"providing a lease for goods if the lease creates a security interest in the goods leased," but it is not a “true lease” as Article 2A of the New York Uniform Commercial Code (NY-UCC) defines; N.Y. U.C.C. Law § 2-A-103(j) (McKinney)(“ “Lease” means a transfer of the right to possession and use of goods for a term in return for consideration, but a sale, including a sale on approval or a sale or return, or retention or creation of a security interest is not a lease. Unless the context clearly indicates otherwise, the term includes a sublease.”); 23 NYCRR § 600.0(w).

[vii] N.Y. Fin. Services. Law § 801(c). “Open-end financing” is defined as “an agreement for one or more extensions of open-end credit, secured or unsecured. . .. “Open-end financing” includes credit extended by a provider under a plan in which: (i) the provider reasonably contemplates repeated transactions; (ii) the provider may impose a finance charge from time to time on an outstanding unpaid balance; and (iii) the amount of credit that may be extended to the recipient during the term of the plan (up to any limit set by the provider) is generally

made available to the extent that any outstanding balance is repaid."

[vii] N.Y. Fin. Services. Law § 801(d). "Closed-end financing" is defined as "a closed-end extension of credit, secured or unsecured, including equipment financing that does not meet the definition of a lease under section 2-A-103 of the uniform commercial code, . . .

"Closed-end financing" includes financing with an established principal amount and duration."

[viii] N.Y. Fin. Services. Law § 801(d). "Closed-end financing" is defined as "a closed-end extension of credit, secured or unsecured, including equipment financing that does not meet the definition of a lease under section 2-A-103 of the uniform commercial code, . . .

“Closed-end financing” includes financing with an established principal amount and duration.”

[ix] 23 NYCRR § 600.19.

[x] N.Y. Fin. Services. Law § 801(k).

[xi] 23 NYCRR § 600.1(f).

[xii] N.Y. Fin. Services Law § 809.

[xiii] 23 NYCRR § 600.3(b).

[xiv] APPENDIX 10A. Truth in Lending—Regulation Z (12 C.F.R. § 1026.4), 3 Fed. Reg. Real Estate & Mortgage Lending Appendix 10A (4th ed.)

[xv] 23 NYCRR § 600.2(a).

[xvi] 23 NYCRR § 600.3(d).

[xvii] 23 NYCRR § 600.4(a).

[xviii] 23 NYCRR §§ 600.6-600.9(a).

[xix] 23 NYCRR § 600.1(a).

[xx] 23 NYCRR § 600.1(af).

[xxi] 23 NYCRR § 600.1(a).

[xxii] 23 NYCRR § 600.17(a).

[xxiii] 23 NYCRR §§ 600.6-600.9.

[xxiv] 23 NYCRR § 600.10.

[xxv] 23 NYCRR §§ 600.12, .13.

[xxvi] 23 NYCRR § 600.14.

[xxvii] 23 NYCRR § 600.11.

[xxviii] 23 NYCRR § 600.15.

[xxix] 23 NYCRR § 600.16.

[xxx] 23 NYCRR § 600.