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Finance Providers Need to Be Aware of New Commercial Finance Disclosure Laws

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While consumer lenders have long been attuned to disclosure requirements under the Truth in Lending Act, many commercial financiers are or soon will be subject to similar state-level obligations. On June 23, 2023, Florida became the sixth state, joining California, Georgia, New York, Utah, and Virginia, to enact a law requiring disclosure of specified information in connection with commercial financing transactions.[1] Other states are considering similar legislation.

Non-bank lenders, including those that provide bridge financing, rescue loans, and similar financings (or who may feel compelled to provide protective advances in order to support their other investments), as well as financial technology ("Fintech") lenders, should take particular note, because these common activities may now be subject to complex and overlapping disclosure requirements where none previously applied.

Not only do these disclosure requirements impose new compliance burdens on financiers whose activities historically fell outside of state licensing requirements, they also may incentivize financiers to reconsider pricing structures or to change the manner in which they structure their financing transactions.

These new disclosure requirements are complex, in part because they apply to a variety of financing transactions, including loans, factoring, and sales of future receivables. The state statutes and regulations also vary significantly in almost every respect: as to which finance providers are covered (and which are exempt); what types of financing transactions are covered, what size transactions are covered, and what the consequences are for failure to comply. The following charts depict some of the differences.

	Size & Types of Transactions Covered				
	Dollar Amount	Loans	True Leases	True Factoring	Sales of Future Receivables
California	$5,000 > x < $500,000	√	√[2]	√	√[3]
Florida	< $500,000	√		√	possibly
Georgia	$50,000 .> x < $500,000	√		√	possibly
New York	< $2,500,000	√		√	√[4]
Utah	< $1,000,000	√		√	possibly
Virginia	< $500,000				√

	Information to Be Disclosed						
	Finance Charge	Interest Rate	Payment Amount	Fees	Total Amount to be Paid	Actual or Estimated Term	Collateral
California	√	√	√		√	√	
Florida				√[5]	√		
Georgia				√[6]	√		
New York	√	√	√	√	√	√	√
Utah			√		√		
Virginia	√		√	√	√		√

	Exempt Finance Providers		
	Banks	Frequency	Others
California	Depository institution (defined)	Person making 5 or fewer transactions incident to its business in a 12-month period	Lender of at least $50,000 to a motor vehicle dealer or affiliate; lender regulated under the Farm Credit Act
Florida	Federally insured depositary institution (or subsidiary or affiliate)	Person making 5 or fewer transactions in the state in a 12-month period	Lender of at least $50,000 to a motor vehicle dealer or affiliate; licensed money transmitter; lender regulated under the Farm Credit Act
Georgia	Federally insured depositary institution (or subsidiary or affiliate)	Person making 5 or fewer transactions in the state during any calendar year[7]	Lender of at least $50,000 to a motor vehicle dealer or affiliate; licensed money transmitter; lender regulated under the Farm Credit Act
New York	Financial Institution (defined)	Person making 5 or fewer transactions in a 12-month period	Lender of at least $50,000 to a motor vehicle dealer or affiliate; technology services provider; lender regulated under the Farm Credit Act
Utah	Depositary institution (undefined)	Person consummating 5 or fewer transactions in any 12 month period[8]	--
Virginia	Financial Institution (undefined)	Person making 5 or fewer financing transactions in a 12-month period	--

	Remedy			
	Fine Payable to State	Imprisonment	Injunction	Loss of Finance Charge
California	Up to $10,000, if willful	Up to 1 year, if willful		
Florida	$500 per violation ($1,000 after notice of a prior violation)			[9]
Georgia	$500 per violation ($1,000 after a prior violation)			[10]
New York	Up to $2,000 ($10,000, if willful)		√	
Utah	$500 per violation ($1,000 after prior violation)			[11]
Virginia			√	√[12]

Who Is Covered?

As noted in the third table above, a number of entities are exempt from the disclosure requirements in these statutes, most commonly, banks. While this is not surprising—many state financial services laws exempt banks from coverage because banks are highly regulated and/or due to banks' preemptive privileges—the new disclosure laws continue to cover Fintech companies that offer products originated by banks. In fact, the drafters of all of these commercial financing disclosure laws appear to have contemplated bank-Fintech origination partnerships and determined that many such arrangements should be subject to disclosure requirements. Thus, even though financing is originated by a bank, if such financing is Fintech-branded and accessible through a Fintech's online platform, the Fintech may be required to provide relevant disclosures.[13] Not only are such disclosures burdensome for Fintechs, the fact of their distribution bolsters the argument that the Fintech, and not the bank, is the "provider" or "True Lender" of the financing. Florida is the only state that appears to have specifically noted that the fact that a Fintech extends an offer of commercial financing "may not be construed to mean that the [Fintech] engaged in lending or financing or originated that loan or financing."[14] While no state or court has yet used this evidence in support of a True Lender claim, it is noteworthy that banks are exempt from disclosure requirements while Fintechs marketing bank-originated products are not.

Additionally, the exemptions for non-banks are complex. For example, each state's law applies only to finance providers that engage in more than five covered transactions in a 12-month period. But it is not clear how that 12-month period is to be determined. None of the statutes refer to "the previous 12 months." As a result, once a finance provider engages in a sixth transaction in a 12-month period, arguably the disclosure requirement kicks in for the preceding five transactions. While it seems doubtful that the statutes are designed to operate retroactively, a finance provider that contemplates engaging in more than five covered transactions in any 12-month period should err on the side of caution and assume that the statute applies.

Which State's Law Applies?

Generally, state financial services regulations are designed to protect state residents that receive the regulated financial services. That is because the regulations seek to protect state residents from unfair, misleading, or otherwise harmful practices of financial services providers. With this mind, one might be tempted to assume that the application of the commercial financing disclosure statutes is based on the location of the finance recipient.

Indeed, that appears to be the approach in Virginia. The Virginia statute defines "recipient" so as to limit the term to "a person whose principal place of business is in the Commonwealth."[15] It then defines the various terms for a covered finance provider as someone dealing with a recipient. As a result, the Act applies only to transactions involving financing extended to a business with its principal place of business in Virginia.

New York and California regulations similarly specify that the obligation to provide any commercial finance disclosures applies only to recipients whose business "is principally directed or managed" within the state.[16] The regulations further allow providers to rely on either: (i) a written representation by the recipient as to whether the recipient is principally directed or managed from within the state; or (ii) the business address provided by the recipient in the application for financing.[17]

While slightly less specific than the laws of Virginia, New York, and California, Florida's statute also clarifies that disclosure requirements turn on the location of the financing recipient. In particular, Florida defines a covered "provider" as "a person who consummates more than five commercial financing product transactions to a business located in the state in any calendar year."[18] Thus, Florida's disclosure requirements appear to be triggered where a provider offers financing to a Florida-based recipient, though Florida does not specify whether it intends the requirements to apply where a recipient's principal place of business is in Florida or merely a single location.

On the other hand, the Georgia statute imposes disclosure obligations on a "provider," which is defined as "a person who consummates more than five commercial financing transactions in this state during any calendar year."[19] There is no specific requirement that either the finance recipient or the transaction be located in the state. Does that mean that a *provider* resident in Georgia would be obligated to provide disclosures to all recipients regardless of recipient location? That seems unlikely—particularly given that the statute also regulates the conduct of "brokers," a term defined to mean a person who "arranges a commercial financing transaction between a third party and *a business in the state* . . . and communicates that offer *to a business located in this state*."[20]

Similarly, the Utah statute requires "a person [engaging] in a commercial financing transaction as a provider in Utah or with a Utah resident" to register with the Utah Department of Financial Institutions. The disclosure obligation, however, is not limited to providers who are registered or required to be registered, but the term "provider" is defined as a person who consummates more than five commercial finance transactions "in the state" in any calendar year. There is also an exemption for a provider that consummates five or fewer commercial financing products "in the state" during any 12-month period. There is, however, no guidance on how to determine whether a transaction is consummated in the state.

The uncertainty about what disclosures are required will only increase—as will the possibility that more than one state's law applies to a single transaction—as these statutes proliferate. For now, finance providers should be cautious and seek legal advice any time the finance recipient is located in, the finance provider is located in, the transaction is entered into in, or payments are to be made in a state with a disclosure statute. One thing that is almost certain is that finance providers cannot avoid disclosure requirements by having the finance documents select the law of a state that has no such statute. Under applicable conflicts of laws analyses, a court in a state with such disclosure requirements is likely to regard the statute mandating disclosure as an expression of fundamental policy that contracting parties cannot generally avoid.[21]

Potential Surprises in Coverage—Increases in Credit & Bridge Loans

The state laws are unclear as to whether and how they apply to refinancings and renewals. The New York law is the only one to expressly address them, and it does impose disclosure requirements on some renewals. The California regulations effectively require disclosure any time there is an offer that would

increase the interest rate, unless the increase were to resolve a default. That exception for post-default transactions would, however, likely not apply if the finance recipient was simply negotiating for a renewal or extension of the financing in advance of maturity.

Lenders and other providers of commercial finance that normally do not engage in transactions within the dollar limits of these disclosure statutes—for example, they lend more than $500,000 to California borrowers or more than $2.5 million to New York borrowers—might be tempted to think that these laws do not apply to them. Think again. Consider a situation in which the financed business requests a small increase in credit or a small bridge loan. Such a transaction might well fall within the regulations because the incremental loan does not exceed the applicable dollar limit, even though the entire credit exceeds the limit. If the lender engages in, or is likely to engage in, more than five such transactions in a 12-month period, the disclosure requirements would, apparently, apply.

Meaningful Changes to the Online Financing Experience—Disclosure of APR and Disclosure Display and Acceptance

Providers that *are* subject to these laws may wish to reconsider how they structure their products. First, both New York and California require that all "finance charges" (defined to include all charges that would be considered finance charges under Regulation Z (if Regulation Z were applicable)), any discount, factor rate, or other specified charges be displayed as an annualized percentage rate ("APR").[22] For some providers, this means that applicants will be forced to view exorbitant APRs before contemplating a given transaction. Particularly in the online context, this could lead to a drop in customers submitting an application or consummating a transaction. Accordingly, some financiers might wish to consider ways to avoid high APRs, such as by increasing the price for other products or services or revising the fee structure for the commercial financing transaction. For example, financiers might charge a periodic participation fee for financing products or raise late fees. These types of fees are excluded from the definition of "finance charge" under TILA,[23] and therefore are not incorporated into an APR calculation for purposes of New York and California's commercial financing disclosure laws.

Second, the manner in which the disclosures must be displayed and accepted may necessitate changes to certain providers' user interfaces. For example, California and New York require that "the disclosures [] be presented to the recipient as a separate document."[24] The California Department of Financial Protection and Innovation's ("DFPI") Initial Statement of Reasons clarifies that the purpose of the separation requirement is to "encourage recipients to notice and review the disclosures required by statute. This requirement is necessary because a recipient is less likely to review disclosures if they are included in a voluminous document."[25] While Regulation Z mandates "clear and conspicuous" presentation of required disclosures,[26] a similar standard is not present in the commercial financing laws. As such, the manner in which disclosures must be displayed to applicants remains unclear. Must such disclosures be, in fact, visually displayed prior to consummation? Or can they be hyperlinked, thus providing applicants with the ability to view the disclosures only if they so choose? In fact, the DFPI specifically declined to substantively respond to comment letter from Small Business Financial Solutions, LLC (RapidAdvance) inquiring whether a page break is a sufficient separation where the disclosure and agreement are both contained in the same email attachment or hyperlink.[27] While the more conservative approach would be to visually display the disclosure, many online contracts are accepted and enforceable when presented via hyperlink. The fact that the regulators did not adopt a "clear and conspicuous" standard may be implicit acknowledgement that such disclosures need not meet the high standard of TILA.

California and New York also require that the financing recipient "sign" the disclosure prior to consummation of the financing.[28] This requirement is unusual and does not have an obvious analogue in the consumer space. While a checkbox or other affirmative action is likely sufficient to indicate customer consent, providers will need to build in this type of functionality into their user interface. Providers should

be sure to implement an automatic date stamp preserving the applicant's assent and provide a copy of the disclosure to the recipient.[29]

Finally, complicating things even more, the states' disclosure requirements often conflict and thus, cannot all be fully satisfied via a single disclosure. For example, California limits the disclosures provided to "only" the information specified in the regulation.[30] Virginia, however, requires that a description of collateral be identified in its disclosures.[31] Because a description of collateral is not required by California, including such a description would seemingly not be permitted by California. As a result, providers seeking to develop a single disclosure to meet all state requirements may be thwarted in that effort. Without a single, uniform disclosure, providers may be forced to develop separate disclosures for each state—thus forcing providers to build out state-specific channels by which to submit applications or to modify the form of disclosures based on the state of residence set forth by an applicant in its financing application.

A Look Ahead

The Uniform Law Commission ("ULC") recently created a Study Committee to look into commercial finance disclosure and recommend whether the ULC should pursue uniform legislation on the subject. The Committee's first meeting was in March of this year and, since then, the Committee has been engaged in outreach to potential stakeholders and other interested parties. Given that commercial finance is largely a matter of interstate commerce and indifferent to state borders, it seems likely that there will be a strong desire for uniform legislation on the subject. Stay tuned.

If you have any questions concerning these developing issues, please do not hesitate to contact either of the following Paul Hastings New York lawyers:

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[1] *See* Cal. Fin. Code § 22780.1 & §§ 22800–22805 (enacted 2018); Fla. Stat. §§ 559.961–559.9615 (enacted 2023); Ga. Code §§ 10-1-393.18–10-1-393.19 (enacted 2023); N.Y. Fin. Serv. Law §§ 801–812 (enacted 2020 and amended 2021); Utah Code §§ 7-27-101–7-27-301 (enacted 2022); Va. Code §§ 6.2-2228–6.2-2238 (enacted 2022).

[2] If the merchant has an option to purchase. *See* Cal. Fin. Code § 22800(j).

[3] Covers an "asset-based lending transaction," defined to mean "a transaction in which advances are made from time to time contingent on a recipient forwarding payments received from one or more third parties for goods the recipient has supplied or services the recipient has rendered to that third party or parties." Cal. Fin. Code § 22800(c).

[4] Covers "sales-based financing," defined to mean "a 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." N.Y. Fin. Serv. Law §§ 801(j). This may include a reconciliation process.

[5] Expressed as the total dollar cost, calculated as the difference between the amount disbursed to the business and the amount to be paid by the business. Fla. Stat. § 559.9613(2).

[6] Expressed as the total dollar cost, calculated as the difference between the amount disbursed to the business and the amount to be paid by the business. Ga. Code § 10-1-393.18(e)(3).

[7] The statute defines a covered provider as someone who consummates more than five commercial financing transactions in this state "during any calendar year" but then exempts a provider who consummates five or fewer commercial financing transactions in the state "during any 12 month period." Ga. Stat. § 10-1.393.18(a)(10), (b)(5). It is unclear why the statute uses these two, slightly different, time periods.

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[8] In addition to exempting a provider who consummates five of fewer commercial financing transactions in the state "during any twelve month period," Utah Code § 7-27-102(5), the statute defines a provider to be a person who consummates more than five such transactions in the state "during a calendar year." Utah Code § 7-27-10(9)(a). It is not clear why the statute uses these two, slightly different, time periods.

[9] Expressly neither affects the enforceability of the underlying agreement not creates a private right of action. Fla. Stat. § 559.9615(2)(c), (3).

[10] Expressly neither creates a private right of action nor affects the enforceability of the underlying agreement. Ga. Code. § 10-1-393.18(j), (k).

[11] Expressly neither creates a private right of action nor affects the enforceability of the underlying agreement. Utah Code § 7-27-301(4), (5).

[12] This is unclear. Va. Code § 6.2-2236 provides that "[i]f any provision of a sales-based financing agreement violates this chapter, such provision shall be unenforceable against the recipient."

[13] *See* Cal. Fin. Code § 22800(m), defining "provider" to mean "a person who extends a specific offer of commercial financing to a recipient. 'Provider' also includes a nondepository institution which enters into a written agreement with a depository institution to arrange for the extension of commercial financing by the depository institution to a recipient via an online lending platform administered by the nondepository institution." *See also* 10 Cal. Code Regs. tit. 10, § 900(a)(24) (defining the term "administered by" to "exclude[] arrangements where a nondepository institution provides technology or support services for a depository institution's commercial financing program, provided that the nondepository institution has no interest, or arrangement or agreement to purchase any interest in the commercial financing extended by the depository institution in connection with such program, and the commercial financing program is not branded with a trademark owned by the nondepository institution."); N.Y. Fin. Serv. L. § 801(h) (defining "provider" as "a person who extends a specific offer of commercial financing to a recipient. Unless otherwise exempt, 'provider' also includes a person who solicits and presents specific offers of commercial financing on behalf of a third party" and exempting "a person acting in its capacity as a technology services provider, such as licensing software and providing support services, to an entity exempt under this section for use as part of the exempt entity's commercial financing program, provided such person has no interest, or arrangement or agreement to purchase any interest in the commercial financing extended by the exempt entity in connection with such program." *Id.* § 802(b).); Fla. Stat. § 559.9611(10) (defining "provider" to include "a person who enters into a written agreement with a depository institution to arrange a commercial financing transaction between the depository institution and a business via an online lending platform administered by the person. The fact that a provider extends a specific offer for a commercial financing transaction on behalf of a depository institution may not be construed to mean that the provider engaged in lending or financing or originated that loan or financing."); Ga. Code § 10-1-393.18(a)(10) (defining "provider" as "a person who consummates more than five commercial financing transactions in this state during any calendar year and includes, but is not limited to, a person who, under a written agreement with a depository institution, offers one or more commercial financing products provided by the depository institution via an online platform that the person administers."); Utah Code § 7-27-101(9)(b) (defining "provider" to include "a person who, under a written agreement with a depository institution, offers one or more commercial financing products provided by the depository institution via an online platform that the person administers.").

[14] Fla. Stat. § 559.9611(10).

[15] Va. Code § 6.2-2228.

[16] Cal. Code Regs. tit. 10, § 954; N.Y. Comp. Codes R. & Regs. tit. 23, § 600.24.

[17] *Id.*

[18] Fla. Stat. § 559.9611(1).

[19] Ga. Code § 10-1-393.18(10).

[20] Fla. Stat. § 559.9611(3); Ga. Stat. § 10-1-393.18(a)(3).

[21] *See* Restatement (Second) of Conflict of Laws § 187(2)(a).

[22] *See* N.Y. Fin. Law § 801(e); Cal. Code Regs. tit. 10, § 940(a).

[23] 12 C.F.R. § 1026.4(c)(2), (4).

[24] Cal. Code Regs. § 901(a)(6); 23 N.Y. Comp. Codes R. & Regs. § 600.5(e).

[25] *See* Section 2060(a)(6), DFPI Initial Statement of Reasons, p. 13.

[26] 12 C.F.R. §§ 1026.5(a)(1), 1026.17(a)(1).

[27] *See* Comment 5.11.10; Response to Comment 5.11.10 in DFPI Final Statement of Reasons, p. 191.

[28] Cal. Code Regs. § 901(a)(2); 23 NYCRR § 600.5(b).

[29] Cal. Code Regs. § 901(a)(11); 23 NYCRR § 600.5(j).

[30] Cal. Code Regs. § 916.

[31] Va. Code § 6.2-2231(8).