

# Goodwin Alerts

## July 27, 2020

### New York to Require Consumer Credit-Like Disclosures by Factors, Merchant Cash Advance Providers, and Certain Fintechs

by Alexander J. Callen

#### **Speed Read**

New York's legislature has passed a bill requiring providers of commercial financing, including non-loan commercial financing, to provide recipients with comprehensive consumer credit-like disclosures. In this *Fintech Flash*, we tackle the critical provisions that apply to factors, merchant cash advance providers, and certain Fintechs partnering with them.

#### **BACKGROUND**

The New York Senate and Assembly passed [S5470](#) on July 23, 2020, and the bill will become law pending Governor Cuomo's signature. The bill adds a new Article (Article 8) to the New York Financial Services Law. Article 8 does not require factors, merchant cash advance providers, or financial technology companies (Fintechs) to obtain lender licenses, but it does require them to deliver comprehensive consumer credit-like disclosures to commercial financing recipients regarding the amount, pricing, and other transaction terms. The bill also authorizes the Superintendent of the New York Department of Financial Services (DFS) to issue regulations governing such disclosures.

Under Article 8, a person that extends or that solicits and presents on behalf of a third party (provider) a specific offer of commercial financing of \$500,000 or less to a person (recipient) must provide the recipient with and obtain the recipient's signature on cost disclosure statements before consummating the transaction. "Commercial financing" includes open- and closed-end loans, sales-based financing, factoring transactions, and, as specified by the DFS, "other forms of financing." A transaction is commercial if the recipient does not intend to use the proceeds primarily for personal, family, or household purposes. Providers may rely on and should document a recipient's statement to such effect.

#### **FACTORS AND MERCHANT CASH ADVANCE PROVIDERS MUST DELIVER CONSUMER CREDIT-LIKE DISCLOSURES TO RECIPIENTS**

Providers must give recipients disclosures when a specific offer for commercial financing is extended. A "specific offer" means the specific terms of the transaction (including the price or amount quoted to a recipient) based on information obtained from or about the recipient, which would be binding on the provider if accepted by the recipient. The format of the required disclosures will be determined by the DFS.

#### **Factoring disclosures**

Under Article 8, a "factoring transaction" is an accounts receivable purchase transaction that includes an agreement to purchase, transfer, or sell a legally enforceable claim for payment held by a recipient for goods the recipient has supplied or services the recipient has rendered that have been ordered but for which payment has not yet been made.

Factors must disclose the following six items to recipients: the amount of purchase price and the disbursement amount, if different; finance charge (including the face value discount of the purchased accounts); annual

percentage rate (APR); total payment amount; other potential fees; and a description of the receivables purchased and any additional collateral or security.

A factor must calculate APR as a “single advance, single payment transaction” according to Appendix J to Regulation Z, where the purchase price is the amount financed, the purchase price minus the finance charge is the payment amount, and the term is either (a) the due date of the purchased account, or (b) the average payment period of the account-debtor owing on the purchased account, using historical data from a period not to exceed the previous 12 months.

### **Sales-based financing disclosures**

Under Article 8, a “sales-based financing transaction” is a transaction repaid by a recipient over time as a percentage of sales or revenue, in which the payment amount fluctuates according to the recipient’s sales or revenue volume, and similar transactions that include a true-up mechanism for reconciling fixed payment amounts to adjust the fixed payments that have been made to an amount that is a percentage of sales or revenue. This category of transactions includes typical merchant cash advance and business cash advance arrangements.

Providers of sales-based financing must disclose the following nine items to recipients: the total amount of financing and disbursement amount, if different; finance charge; APR; total repayment amount; estimated term (i.e., estimated duration of periodic payments, based on projected sales volume); payment amounts (based on projected sales volume), with special requirements for variable and fixed payments; other potential fees; prepayment penalties; and a description of any collateral or security.

A provider of sales-based financing must calculate APR in accordance with Section 1026.22 of Regulation Z, based on the estimated term of repayment and periodic payment amounts, which are in turn determined according to a recipient’s projected sales volume.

Significantly, a provider of sales-based financing must notify the DFS of the method it will use to calculate projected sales volumes across all instances of sales-based financing. A provider may choose either the historical method (based on average historical volumes) or the opt-in method (based on projected volumes that the provider elects, and subject to additional reporting and accuracy tolerances). Both methods are described more fully in Article 8.

### **ADDITIONAL DISCLOSURES ARE REQUIRED FOR RENEWAL FINANCING**

If, to obtain new commercial financing, a provider requires a recipient to pay off (i.e., roll over) the balance on an existing commercial financing from the same provider, two additional disclosures must be provided: the amount of new financing used to pay off prepayment charges or unpaid interest, and the total amount reduced from the disbursement amount. Providers should give these disclosures where recipients roll over into the same type of commercial financing and where they switch from one type of commercial financing to another.

### **THE DISCLOSURE OBLIGATIONS DO NOT APPLY TO EVERYONE, BUT MAY STILL BE IMPOSED ON FINTECHS THAT DO NOT PROVIDE ANY FINANCING**

Article 8 does not apply to financial institutions (such as a [bank](#), trust company, [industrial loan company](#), thrift, or credit union); persons engaged in *de minimis* commercial financing activity (i.e., five or fewer transactions per year); lenders regulated under the federal Farm Credit Act; commercial financing secured by real property; or leases (as defined in New York Uniform Commercial Code § 2-A-103).

However, unlike a [similar California law](#) enacted in 2018, Article 8 is noteworthy for its application to persons that solicit and present specific offers of commercial financing on behalf of a third party. Fintechs should pay

special attention here, especially if considering or already participating in a [bank partnership arrangement](#). Although Article 8 supplies an exemption for a person acting in the capacity of a technology service provider (such as licensing software and providing support) to another person that is exempt from Article 8, this exemption is not available if the technology service provider has an interest in, or arrangement to purchase an interest in, commercial financing extended by the other exempt person.

### NEXT STEPS

Market participants will need to act quickly to comply. Article 8 will become effective approximately six months after Governor Cuomo signs the bill into law, and each violation of Article 8 may result in civil penalties of up to \$2,000, or up to \$10,000 if the violation was willful. Providers who knowingly violate Article 8 may also be subject to additional consequences, such as a permanent or preliminary injunctions.

### WE CAN HELP

Let our team of experienced Fintech lawyers help you navigate through this regulatory development. Please contact the [author](#) or another member of [Goodwin's Fintech practice](#). Goodwin's Fintech team has over 150 lawyers practicing in every Fintech vertical, including lending, alternative lending (e.g., factoring, merchant cash advances, income share agreements, home equity appreciation products), deposits, payments, digital currency and blockchain, wealth management, bank partnerships and charters, and transactions.

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