California & New York State Truth-in-Lending Law Update: What You Don't Know CAN Hurt You — The Time to Act is NOW

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Following an extended process of commentary, lobbying and rulemaking, California now has its truth-in-lending (TIL) law and implementing regulations on the books. New York is close behind, as the New York Department of Financial Services (NYDFS) published revised proposed regulations in September 2022 that are subject to public commentary through the end of October 2022. While industry members have pushed to make the implementing regulations in these two states as consistent as possible — and while NYDFS has admitted to consulting directly with the California Department of Financial Protection and Innovation (DFPI) — NYDFS expressly declined to conform its regulations to those of California and proposed significant new changes to its regulation that, if implemented, will present new compliance challenges for the industry. Commercial lenders and brokers should therefore act immediately to establish internal systems for complying with both laws and those from other states that are on the horizon. Given the complexity of the state regulations, industry players should consult with counsel to ensure compliance. Nonetheless, we address some of the common questions that have arisen out of the regulatory schemes set forth by both states.

When do the laws in California and New York take effect?

The California law takes effect on December 9, 2022. New York's implementing regulations are open for public comment until October 31, 2022, but will not take effect until six months after the regulations are finalized.

What do the TIL laws require?

Both New York's and California's TIL laws require that written disclosures be made to the potential borrower (recipient) in a separate form (Disclosure), at or before the time a specific commercial financing offer is extended to a recipient. The Disclosure must be presented to the recipient as a separate document from any other contract, agreement, or other disclosure document, but may be mailed or transmitted in a package that contains other documents. Each law, along with implementing regulations, indicates exactly what must be disclosed based on the transaction type (as set forth in the law). The Disclosure must generally contain: the total amount financed, the estimated APR, finance charge, total repayment amount, the estimated total payment amount, the payment terms, the estimated term, prepayment information, a description of other fees and charges, a description of the collateral with security interests listed (New York), and information on broker compensation (New York). Importantly, the Disclosure must be signed by the recipient and returned to the provider prior to the proceeding further or consummating the commercial financing. Finally, both states required a separate itemization form (which does not have to be signed) that details to whom certain of the financed funds are paid (e.g., vendors, brokers, etc.)

Did California and New York finally provide a model Disclosure Form?

No. Unfortunately, neither state provides a model Disclosure. Both, however, require very specific formatting of Disclosures — dictating columns, rows, and fonts to be used — as well as specific language that must be included in the various sections of the form depending on the type of transaction. Significantly, New York's latest round of proposed regulations altered the format of the Disclosure for several types of transactions by adding additional rows that are not required in California. Although there are instances where the provider may give additional information and explanation, the provider should strictly adhere to the exact wording mandated by the regulations.

Can I structure transactions to avoid having to provide a Disclosure?

The laws provide a number of exemptions based on who is lending (e.g., financial institutions, motor vehicle dealers, technology service providers & tech companies), the type of transaction involved (secured by real property, pursuant to Farm Credit Act), the number of transactions in a year (five or less in a year) and the amount of the transaction ($500,000 for California; $2,500,000 for New York). If you cannot meet any of the above exemptions, the most straightforward way to avoid having to comply is to structure the transaction as lease. In this regard, both laws exempt true leases under UCC Article 2A.

Are bank subsidiaries exempt?

No. There is no exemption for bank subsidiaries in either New York or California. In fact, NYDFS expressly declined to provide such an exemption, stating that the New York law "does not provide exemptions for subsidiaries of federal-

ly-chartered banks or foreign banks, among other exempted entities, to the disclosure requirements."

Is the requirement for making the Disclosure based upon where the recipient is located, where the provider is located or where the transaction is negotiated?

Potentially all three. California and New York both now have so-called "jurisdictional nexus" requirements in their regulations that determine when a Disclosure is required. California requires a Disclosure where the recipient is "principally directed or managed" from that California. While the proposed New York regulations also require disclosure where a recipient is "principally directed or managed" from New York, the proposed New York regulations drastically expand the scope of jurisdiction by requiring a Disclosure anytime (i) the provider is principally directed or managed from New York or (ii) if the transaction was negotiated from a location in New York. The only exception is that, if the state where the recipient is principally directed or managed has implemented its own state TIL law (such as California), that state's law will govern over New York (so long as a disclosure is provided). Accordingly, this extraordinary jurisdictional provision will effectively require New York based lenders to provided Disclosures in all 50 states.

Who prepares the Disclosure (and what about discounting?)

A "provider" or "financer" is responsible for preparing the Disclosure and must provide them to the broker for transmission to the recipient. Who exactly qualifies as a "provider" or "financer," while not entirely clear, is set forth in both laws and generally refers to the entities which extend or provide a specific offer of commercial financing to a recipient. In cases where a broker is documenting the transaction on their own paper and/or is providing the initial funding, the broker is responsible for preparing and providing the Disclosure, even if the transaction will later be discounted. Lenders who are buying paper should not only get a representation and warranty that the proper disclosure has been made but, where practical, they should review the disclosure forms the broker will use to ensure that its is compliant with the laws.

Are there any other issues I should be concerned about when a transaction is assigned after a Disclosure is made?

Yes. New York's proposed regulations inserted a notice requirement where there is an assignment, sale, or transfer of servicing. Specifically, the "transferor servicer" is required to provide notice to the recipient no less than 15 days before the effective date of the transfer and the "transferee servicer" is also required to provide notice within 15 days after the effective date of transfer. The written notice must include the effective date of transfer, the contact information for the transferee and transferor servicer, the date that the transferor servicer will cease accepting payments and the date the transferee servicer will begin accepting payments, and a statement that the transfer of servicing does not affect any term or condition of the commercial financing agreement. The regulations also provide the recipient with a safe harbor as to payments, mandating that a provider not consider a recipient's payment late (or declare a default) if, up to 60 days following the transfer, the original servicer receives payment from the recipient. California does not have a similar notice of transfer requirement.

Is a separate disclosure required each time the terms of the proposed financing change?

Yes. A new disclosure is required any time the terms of a commercial financing contract are amended, supplemented, or changed, prior to the recipient agreeing to the changes, if the resulting changes to the contract would result in an increase to the annual percentage rate. This would include situations where the interest rate has changed between the time of the initial Disclosure and the closing of the transaction. Although there are provisions for inadvertent errors which require certain notices to the recipient and for "tolerances" as to certain figures, a provider should not rely on those provisions where the terms change and should provide a new disclosure. Note that there is an exception in both the California and New York regulations that allows for only one Disclosure if multiple offers are extended to a recipient and the recipient is allowed to choose which financing they want. However, the practical application of this approach is unclear, as it may create confusion with the recipient as to what is or is not a specific offer of commercial financing.

What obligations do brokers have under the laws?

The regulations in both states anticipate that brokers will transmit Disclosures to the recipients and set up a structure for the provider to effectively police the broker. A broker is not liable for the contents of the Disclosure if the broker transmits the Disclosure "as is" or "unaltered" to the recipient and the broker provides the finance company with proof of transmission. Likewise, brokers are prohibited from making certain disclosures (e.g., rate, price, cost of financing) to the recipient prior to the recipient receiving the Disclosure. The regulations for both states put a further onus on the financing company in relation to the broker relationship, requiring that the finance company: (i) put in place "contractual requirements that brokers timely provide" documentation that they transmitted the Disclosure; (ii) timely investigate facts would put the finance company on notice that the broker has not provided the Disclosure; and (iii) discontinue relationships with any brokers who do not comply with their obligations under the law. Therefore, both brokers and finance companies should be cognizant that they have their own unique duties vis-à-vis each other under the laws and should ensure they are complying independently of one another.

What other states do I need to worry about?

In addition to New York and California, Utah has also passed legislation requiring financial disclosures in commercial finance transactions. Utah's law will go into effect on January 1, 2023 but will generally exempt many of the transactions in the equipment financing industry. That being said, the law contains a registration requirement which will likely require you to register even if your transactions are exempt. Legislation requiring enhanced disclosures has been introduced but not yet passed in Connecticut, New Jersey, Maryland, Virginia, North Carolina, Mississippi, and Missouri. We are seeing a nationwide trend towards requiring financial disclosures in commercial finance transactions and this area continues to develop.

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