State Truth-in-Lending Laws are Around the Corner: Are Your Disclosure Forms Ready?

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After years of anticipation, lobbying and hand-wringing, both New York and California are poised to implement their respective truth-in-lending (TIL) laws. Although California was the first state to pass the historic legislation in 2018, the effective date of the law has been delayed while the California Department of Financial Protection and Innovation (DFPI) continues to draft and revise proposed regulations after several rounds of public notice-and-comment. New York is thus set to leapfrog California in enforcing its legislation, the Commercial Finance Disclosure Law (CFDL), with a current effective date slated for January 1, 2022. However, even with this impending deadline, the New York Department of Financial Services (NYDFS) has only recently promulgated draft regulations that are only now being subject to public scrutiny and comment.[1] Thus, with only a few months until the New York TIL requirements become mandatory, commercial lenders and brokers have been scrambling to figure out exactly how to ensure they will be in compliance. Discussed below are some of the common questions that many companies in the equipment finance industry are asking.

Does the Disclosure need to be a separate form?

Yes. Both New York's and California's TIL laws require that the disclosures to the customer be made in a separate form (the "Disclosure"). Under New York's TIL law the Disclosure must generally contain: the total amount of financing, the finance charge, the estimated APR, the total repayment amount, the term, the payment amounts, a description of other fees and charges, prepayment information, and a description of the collateral with security interests listed. Similarly, California generally requires disclosure of the following: the total amount of funds, the total dollar cost of the financing, the term, the method, frequency, and amount of payments, and prepayment policies. Each law, as well as the California proposed regulations, indicate what exactly must be disclosed based on the transaction type.

Can the Disclosure be part of the document package sent to the customer?

No. Both New York's and California's TIL laws are clear that the Disclosure must be provided at the time a specific financing offer (defined in the laws) is made to the customer. Moreover, the finance company must obtain the signature of the customer on the Disclosure form prior to proceeding with the financing transaction. Likewise, New York's draft regulations require that the provider maintain a copy of "each disclosure that it generates" and evidence of broker transmission to the customer for a period of four (4) years.

Can a "Master" Disclosure form be used to satisfy the requirements for both states?

Unlikely. While the content of the disclosures is substantially similar in both laws, the formatting requirements are very specific. The latest round of California's draft regulations explicitly sets forth the requirements for each type of transaction, not only requiring the precise language to be used for each type of disclosure, but dictating the exact format. These mandates include, among other things, the wording that must appear on the top and bottom of the Disclosure, the number of rows and columns to be used (and the content of each), any attachments to include (yes, the disclosure may be more than one page) and the style and size of the font that must be employed. Incredibly, the font sizes that must be used in a single Disclosure may range from 10 to 16 font and can change from line to line. New York's draft regulations similarly specify, among other things, the exact wording on top and bottom of each Disclosure, the number of rows and columns for each type of Disclosure and the font sizes for to be used. However, not to be outdone by California, New York also addresses the column width ratio (with a 3:3:7 ratio safeharbor), requires all cells to be

outlined, limits the number of words (60 or less) that are required to provide the recipient with a "short explanation" as to certain disclosures and further mandates that, if disclosures are made electronically, a provider shall include a method for the recipient to submit their signature that complies with the New York Electronic Signatures and Records Act, State Technology Law. Assuming other states follow suit and enact similar TIL laws, the question will be whether (and to what extent) those states follow California or New York as models or whether they create their own laws and forms. Regardless, it is evident that industry players will ultimately need to have at least a few, if not many, different forms and will not be able to rely on a master disclosure form.

Do the laws apply to brokers?

Yes, both state laws anticipate that brokers may be transmitting the Disclosure to the customer and the draft regulations provide further guidance as to the finance company/broker relationship. The draft regulations for both California and New York clarify that a broker should generally only serve as a conduit for transmitting the Disclosure to the customer. The New York draft regulations, in fact, define a broker as "any person other than a financer who communicates a financing payment, amount, rate or price relating to a commercial financing to a recipient based upon information from, or about, the recipient." Both draft regulations further provide that, a broker is not liable for the contents of the Disclosure if the broker transmits the Disclosure "as is" or "unaltered" to the customer and both require that the broker provide the finance company with proof of transmission. Likewise, both draft regulations prohibit brokers from making certain disclosures (e.g., rate, price, cost of financing) to the customer prior to the customer receiving the Disclosure from the finance company via the Disclosure. However, while this appears to be an absolute prohibition in New York, California's regulations only appear to ban such communications in writing prior to a Disclosure transmission. Finally, New York's draft regulations 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.

Are bank subsidiaries/affiliates exempt from the disclosure requirements?

No. Although banks are exempt, there is nothing in either New York or California's legislation or California's proposed regulations that would extend this exemption to a bank's subsidiaries or affiliates.

Is there a way to structure a transaction to avoid the disclosure requirements?

Yes. The laws provide a number of exemptions based on who is lending (e.g., financial institutions, motor vehicle dealers), the type of transaction involved (secured by real property), 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). Note that, as to the $2,500,000 threshold in New York, the draft regulations state that this is "the aggregate amount that a recipient may receive under a commercial financing agreement and not the amount of any particular advance. If you cannot meet any of the above exemptions, the most straightforward way to avoid having to comply is to structure the transaction as a commercial lease. In this regard, both laws exempt true leases under UCC Article 2A.

Are there any other states that may adopt TIL laws in the near future?

Yes. New Jersey and North Carolina both have pending legislation. The New Jersey bill, Senate No. 233, was reintroduced this session. Notably, this bill had previously passed both houses but was never enacted into law. North Carolina House Bill 969 was introduced on May 11, 2021. One unique aspect about this proposed legislation is a separate requirement for registering with the state. Specifically, the bill requires that a covered lender, meaning any person that extends a specific offer of commercial financing to a borrower, operating in North Carolina must register with the North Carolina Commissioner of Banks and pay a $1,000 registration fee.

Should I start drafting a form Disclosure?

This is perhaps the hardest — and most frequently asked — question given the fact that both the NYDFS and DFPI are not finished with the regulatory process. As noted, California appears to be nearing the end of its regularly process, but even the latest version of the regulations change the disclosure requirements — who's to say there won't be more? Fortunately, even if the regulations are finalized, there will be at least a six-month transition period before the law takes effect. This will allow for the development of a compliant Disclosure. New York, on the other hand, just issued draft regulations on September 21, 2021, with the law set to be effective January 1, 2022. There will almost certainly be public comments submitted on these draft regulations and, similar to California, there will likely be significant changes from the draft version to the finalized regulations. Finance companies operating in both states are thus left with the text of the law and unfinished regulations which themselves raises additional questions. Despite this uncertainty, many finance companies are nonetheless preparing model disclosure forms based upon the present law and draft regulations knowing full well that they may ultimately be useless once New York and California finalize their regulations. However, given the looming effective date of the New York law, as well as the risk of both monetary fines and other penalties for noncompliance, you cannot wait any longer to draft a form disclosure and otherwise prepare to comply with the law.

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1. On the eve of publication of this article, the NYDFS issued draft regulations "in order to facilitate implementation of the CFDL in time for the January 1, 2022 deadline." The regulations are subject to a 60-day public comment period once published in the NY State Register.