

Regulation of Commercial Finance Ramps Up

State legislation and enforcement aimed at commercial lessors and lenders continue at frenzied pace



IN RECENT YEARS, commercial finance companies have faced a patchwork of state laws governing their business, and scrutiny of their activities appears to be on the upswing. Two states that are home to substantial commercial finance activity—California and New York—have new requirements for consumer-style disclosures and are signaling greater interest in enforcement and licensing of these activities. While these developments merit careful attention from companies doing business in California and New York, they may also signal broader interest nationwide in regulation of commercial finance.

California Commercial Financing Disclosures

California in 2018 became the first state to require nonbank lenders and other finance companies to make consumer-style disclosures in some commercial transactions, including for small business loans. The law requires covered lenders to disclose, among other things, the total cost of the financing expressed as an annualized rate for each commercial financing transaction. Included in that definition are commercial loans, leases, open-end credit plans, asset-based loans and purchases of receivables, including factoring. The California Department of Financial Protection and Innovation (DFPI) began work in 2019 to implement the law, but final regulations signaling the beginning of enforcement have not yet been promulgated; they are expected to be completed later this year, with compliance by early 2022. The proposed regulations cover the general format and content requirements for each disclosure. They also provide specifics on calculating the APR, including additional details for factoring transactions and sales-based financing transactions, among others.

California DFPI Commercial Financing UDAAP Authority

California last summer enacted a Consumer Financial Protection Law that gave the DFPI expanded enforcement power, including the authority to define unfair, deceptive or abusive acts or practices (UDAAP) in

commercial financing, lease financing and factoring. DFPI just concluded in March a period for public comment on whether its implementing regulations for the law should define specific acts or practices as unfair, deceptive or abusive, and if the DFPI should require the collection and reporting of commercial financing data.

Between the pending disclosure rulemaking and the future commercial UDAAP rulemaking, the stage is set for California to significantly increase its enforcement in the commercial finance market.

New York Commercial Financing Disclosures

New York also recently enacted a commercial financing disclosure law. Like California's law, it requires disclosing the total cost of the financing as an annualized percentage rate and includes exemptions for financial institutions (such as a chartered or licensed bank, trust company, industrial loan company or savings and loan association) and commercial financing transactions secured by real property. While the law initially applied to transactions under \$500,000, Gov. Cuomo in February signed into law an amendment that pushes the threshold to \$2.5 million. The amendments also create a new exemption for vehicle dealers and push the effective date to Jan. 1, 2022.

This legislative trend is not limited to California and New York as Connecticut and New Jersey are also considering enacting similar laws, and a proposed



amendment to the federal Truth-in-Lending Act introduced last summer would create a disclosure requirement for small business financing transactions less than \$2.5 million.

Licensing

Several states have commercial lending licensure requirements for nonbanks. For example, the California Financing Law (CFL) requires a person making more than one commercial loan in a 12-month period to obtain a specific license. Currently, New York's Banking Law has a limited licensure requirement that covers the execution of commercial-purpose loans of \$50,000 or less with a rate above 16 percent. However, pending legislation in New York would expand licensing, requiring a license for those generally engaged in the business of making or soliciting commercial financing products, which include equipment leasing transactions, of \$500,000 or less. The legislation specifying equipment leasing transactions for coverage, which is a relative rarity among states, would exempt banking organizations—as well as any lender who makes or solicits five or fewer commercial financing products within a 12-month period.

State Regulator Commercial Financing Enforcement

California is vigilant about enforcing licensing requirements under the CFL, aggressively targeting unlicensed businesses that broker transactions originated by CFL lenders and others that allegedly execute leases that are functionally structured as loans. The enforcement actions often stem from a license application, which triggers a DFPI review of pre-application activity, leading to fines if the applicant has engaged in unlicensed activity. Of note,

- In 2020, a California-based broker focused on small-business financing proactively disclosed that it had engaged in brokering activity for up to 100 loans without obtaining a license, and immediately

ceased brokering when it determined it needed one. The DFPI acknowledged the broker's responsible conduct, but nonetheless concluded after investigation that the broker had engaged in false, misleading or deceptive advertising, and fined the broker \$250,000.

- In 2017, the DFPI required a Minnesota-based leasing company with no physical presence in California to pay an administrative penalty of \$5,000 for brokering equipment leases for California customers that were deemed to be loans under the CFL. In line with this enforcement action, commercial financing companies applying for licensure in recent years have routinely faced careful scrutiny of their pre-licensure activities to determine if similar enforcement and fines may be applicable.

When DFPI targets a lessor for issuing leases disguised as loans under the CFL, the regulator has ordered refunds or credits to the borrowers for any interest charged over the 10 percent cap for nonexempt lenders.

Other states also appear to be taking a more aggressive enforcement posture for commercial lending, including New Jersey, where the state's attorney general recently took action against several business lenders for allegedly engaging in predatory lending and abusive collection tactics.

As state agencies across the country continue to ramp up their scrutiny, commercial finance companies must take greater care to avoid running afoul of increasingly complex regulatory schemes governing commercial financing. [E](#)



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