
THE CONSUMER FINANCE PODCAST: COMMERCIAL FINANCING REGULATORY DEVELOPMENTS**HOST: CHRIS WILLIS****GUESTS: CALEB ROSENBERG AND JOSH McBEAIN****POSTED: FEBRUARY 2, 2023****Chris Willis:**

Welcome to *The Consumer Finance Podcast*. I'm Chris Willis, the co-leader of Troutman Pepper's Consumer Financial Services Regulatory Group, and I'd like to welcome you to today's podcast where we're going to be talking all about regulatory developments related to small business lending. But before we jump into that topic, let me remind you to visit and subscribe to our blog, consumerfinancialserviceslawmonitor.com, and check out our other podcasts. We have lots of them. We have the *FCRA Focus*, all about credit reporting. *The Crypto Exchange*, all about crypto. And our *Unauthorized Access* podcast, which is all about privacy and data security. All of those are available on all the popular podcast platforms. If you like this podcast, let us know. Leave us a review on your podcast platform of choice, and let us know how we're doing.

Now, as I said, today we're going to be talking about commercial financing regulatory developments. And you may be wondering, why would we be talking about that on *The Consumer Finance Podcast*? The reason for that is there's a great trend going on both in legislatures and among regulatory agencies to extend consumer-like protections to business borrowers and especially small business borrowers. That's what we're going to be talking about today. It's so similar to what we've been experiencing for decades in the consumer finance arena that we think it makes sense to talk about it on our podcast today.

Lucky for me, I have two of my colleagues who are experts in this area to talk about this subject with me today. We have Caleb Rosenberg and Josh McBeain, both of whom are members of our Consumer Financial Services regulatory practice here to talk to us about these developments, and their expertise is going to come shining through as soon as they open their mouths. Caleb, Josh, thanks a lot for being on the podcast today.

Caleb Rosenberg:

Thanks for having me, Chris.

Joshua McBeain:

Thanks very much, Chris. Excited to be here.

Chris Willis:

Gentlemen, one of the things that I've been watching sort of from afar, but that I know you've been watching very closely is the advent of the state laws in places like California and New York that seek to impose truth-in-lending-like disclosure requirements on providers of small business financing. Can you just start off by talking about what's going on in that area?

Caleb Rosenberg:

I think it's really the consumerization of small business finance. It's not just disclosure requirements anymore. Now in Utah and Virginia, we're also seeing some registration

requirements. It's just becoming more and more complex as time goes on. A few years ago, this was a sleepy area where there were very few requirements across the country, and now there's multi-state requirements with different disclosures in different states, and more states ramping up to join the fray. So, it's becoming as complex as consumer lending year after year.

Chris Willis:

Well, and I think it's important too for us to talk for a second about what kind of financing products these state disclosure laws might apply to, because there's a diversity of business models within small business finance. Can you talk to the audience about what some of those products are that are out there in the market, and which ones are in and which ones are out for the purpose of these new state laws?

Caleb Rosenberg:

This is one of the most complicated parts of it and what makes the regulations so difficult to put together from a company side and hard to understand what the regulators are trying to get at, because they apply to many different products that are completely different and much more bespoke than consumer products are. So, on the consumer side, you really only have open-end lending and closed-end lending at the major products. On the small business side, you have factoring, revenue-based financing, MCA, leasing, open-end and closed-end credit. It's just much more varied than the consumer space is, and the states are forcing the providers into disclosures. They're one size fits all, trying to let you compare these different products that are by their nature not directly comparable. So, it becomes very complicated for the providers to be able to actually give these disclosures.

Chris Willis:

If we look at these state laws, we've talked a second about the different kinds of products that they covered. What kind of market participants do they cover, and are there any exceptions to banks or non-banks or different kinds of lenders or other financing providers?

Joshua McBeain:

What's interesting about that is in addition to the complexity that Caleb mentioned about there's more products and these apply to different products than products that don't exist in the consumer space. What's happened in these states ... And we're mainly talking about New York, California, Utah, and Virginia, because those are the states that have been the most active so far, and they're all in varying stages of requiring compliance with these laws. New York's the only one yet where compliance is not required, but that's expected probably here in 2023. So, the other three, compliance actually required. Some states have issued regulations, others have not, but they've all created carve outs.

So, we have different prototypes, but then we have different lenders, right? Financial institutions have pretty much uniformly been excluded from these requirements, and then there's some other specialty exclusions for lenders regulated under the Farm Credit Act, people acting as a technology service provider, and maybe commercial financing that's secured by real estate. So, within the prototypes that Caleb mentioned, open and closed-end, factoring, MCA,

what have you, then you've got who is the lender? Are they subject to the law, or is there an exclusion that they can avail themselves of?

What's interesting about what's been done in these laws, and particularly in New York and California ... And Caleb, I would be interest to get your thoughts on this. If I'm sitting in a bank thinking, "Well, I've got an exclusion that says I'm excluded," then I continue reading these laws and I'm starting to see words like provider or broker. I'm using a lot of third-party providers to deliver my product or market my product to potential customers or even current customers. I mean, do I need to be worried as a financial institution or someone who has an exclusion that my engagement with those servicers would make me subject to these laws?

And I'll ask you one more question, so I'm going to ask you two questions. The second question there is, let's say I'm not a lender. I'm one of those service providers. I'm not in the business of lending, but I'm in the business of hosting a site where small businesses can come and see many different financing options, right? But I'm not lending. I'm just a digital marketplace. Do I need to be worried these laws have swept me up, and now I'm subject to them just as a platform for people to view financing? I mean, Caleb, what are your thoughts on that?

Caleb Rosenberg:

Yeah. I've frequently advised clients on this, both on the partner side and on the bank side. For banks, even if they're not themselves subject to it, if they have third-party providers that they're using that are subject to it for their programs, they're still going to want to have oversight. The regulators are still going to expect them to have oversight of those third parties and making sure that they're complying with the law. I think that banks were excited when they first saw the legislation that included a pretty simple carve out for financial institutions, and then the regulators came in and narrowed those somewhat significantly in New York and California by bringing in certain bank partners where they're purchasing assets after the fact, or if they're using trademarks in California. So, picking a branded program that's the partners program, but papers being transferred after the fact. Whether or not those programs need to comply get very complicated very quickly because the banks have its exemption, but there's this carve out in the regulation, and I would talk to your attorney.

Joshua McBeain:

If I heard you correctly, what you're saying is when the bills were introduced or passed, there was a pretty simple statement or exclusion. You're a financial institution, you're excluded. But what I think I heard you say is that the regulators in drafting regulations included language that could be a trap door for banks or potentially other just websites or service providers. They've expanded it by the defined terms. I mean, how did that play out? What sort of happened there, what the regulators did?

Caleb Rosenberg:

Yeah, it would both be the defined terms and including extra exceptions that apply to brokers, which was not in either New York or California statutes. So, whether someone is a broker, whether someone is a provider, and then who's giving the offer? There's an issue of when the timing of the disclosures are required. So, under TILA in the consumer context, the disclosures tend to be required right at consummation. In this case, the disclosures are required when an

offer is being provided to allow the merchants to compare offers that they're receiving at the time that they're receiving them.

Usually, the banks would try to get around this by simply offering the offer themselves like they would under TILA, getting the process going and being the last person to touch the offer to the consumer or in this case, the small business. These disclosures are frequently required an earlier point in the process. You get them to lead generators and other online marketplaces that are offering a variety of different offers all at once and letting the merchants choose between them, and whether or not disclosures are required at that earlier point in time is something that has to be planned for very carefully in the program to make sure that you're not tripping up any requirements.

Joshua McBeain:

Interesting. So, basically, you'd want experienced counsel to review how those relationships are being set up, and potentially also maybe the contracts and how you're describing relationship to see if you can avail yourself of the exemptions that exist in both the underlying statute and the regulations, or if you've tripped yourself up and you've subjected yourself to providing these disclosures because of the expansive regulations that the regulators are drafted.

Caleb Rosenberg:

Yeah, and I would say that that's true either on the bank side or on the partner side just to make sure that either you're structuring it not trivial to regulations or that if you are, that you have compliance disclosures that can be provided to the small businesses.

Joshua McBeain:

Interesting. Caleb, I have another question for you. When you say the consumerization of business lending, I think what's implied in that is that this is somehow improving upon what previously existed. We're going to provide information in a way that's similar to what consumers receive, and that's something inherently better. And listen, small businesses are an extremely important part of our economy, and they need financing to grow. We want them to have good options and good access to credit. I'm curious what your thoughts are on just how these statutes and regulations are structuring, if you think they effectuate that, if at all.

Caleb Rosenberg:

Yeah. I think that there are different perspectives on that from the consumer side, from regulators and from industry. The intent was clearly to allow out for a few terms that small business owners know and to allow them to compare products in the small business space using those terms. So, regulators assume that small business owners would be familiar with APR, familiar with finance charges, and that these describe the cost of credit in a way that small business owners would know. And then when they have different products in the small business space ... Factoring, MCA, leasing. They realized that they needed to allow small business owners to compare across those products. And to do that, they just adopted the same terms into those other products. This clearly lets people compare the same numbers, but when you get to what those numbers actually mean, it becomes very complicated for products that don't usually use those types of cost disclosures.

Merchant cash advance is a great example of this. The advantage for merchant cash advanced contracts to a small business owner is that it is flexible and the payments adjust over time and there's not a fixed term. But APR is comparison between the cost of the product and the term of the product. So, try to fit square peg into a round hole of putting an APR to a MCA doesn't necessarily give the small business owner valuable information about the transaction. How to disclose these and how to disclose the benefits of MCA or other products that are different than loans within the confines of the regulatory language is difficult. How we present the benefits to small business owners is very difficult and complicated, and is not always what the regulators, I think, intended to come out of the morass of their regulations on the back end.

Joshua McBeain:

That's interesting with the difference with loans and MCA and factoring the different costs and different products there. You said something that was interesting to me. Your consumers are used to seeing APR, an annual percentage rate. They see it whether it's on their mortgage, just a close-end loan when they're purchasing something, or maybe on their credit card, an open-end product, right? The thought is that maybe providing that similar term on a business product could be helpful. You said that they can compare, but is that what these regulators have done? I mean, if I'm a consumer just going about my life clicking away online looking for some open-end financing, and then a moment later I go to a website that maybe an aggregator that hosts commercial financing to get some financing for my small business, am I seeing the same APR under these state laws or is it different?

Caleb Rosenberg:

It can be different. That's the difficult part of it. For example, for open-end products they've forced closed-end disclosures. In New York and California, there's closed-end APR disclosures for open-end products. In the consumer space, the APR credit card is going to be the interest rate, and then fees are separately disclosed. This is the tumor box that you're probably used to seeing. In the closed-end product, a lot of the fees are included in the APR because the regulators wanted to allow you to compare products. They've forced a lot of assumptions on open-end products. They force you into a closed-end box.

So, to your point, these are not the same disclosures that the small business owners are used to seeing for open-end products like credit cards and lines of credit, because they're not open-end disclosures. They're close-end disclosures. So, it's not that these disclosures won't be valuable to the small business owners, but they will be different than what they're used to seeing. And if different states take different approaches, that will create even more confusion across the country going forward. We don't really know exactly what all the other states will do.

Joshua McBeain:

If I have experts or I'm an expert in developing consumer financing products, and I want to develop a product to help small businesses. And I'm just thinking, you know what? We've had these consumer laws for a long time. The powers that be have spoken that this is the way to present information that's helpful to consumers. I'm going to present it the same way and help small businesses. I'm going to go talk to the men and women I have in that department that are experts. We're just going to build our small business lending program that way, and we're

going to be totally compliant. We don't need to worry about any of these laws. What I'm hearing is that's not true, that we would actually violate the state laws?

Caleb Rosenberg:

Yeah. And we've seen that from a number of providers who they'll come to us and say, "Hey, we have this program. It's ready to go. Can you just check this?" And they don't know what the differences are, because they're used to seeing consumer products and they're very experienced with that. There's a learning curve about what these regulations are and how complicated they are and the assumptions they require that require different disclosures and changes in comparison to what we used to in the consumer space.

Chris Willis:

So, gentlemen, we've been talking about these state laws kind of as a unit. And Josh, you mentioned the four states where we have the laws so far. But I assume there's got to be some differences among the laws, because I'm presuming that the four states didn't do the world a favor and adopt a uniform law that's identical in every state. Can you gentlemen talk for a minute about what some of the variations are between these laws, which undoubtedly would be an even greater headache for someone trying to comply with them on a nationwide basis?

Joshua McBeain:

Well, at the outset, Chris, what's funny about that is New York stated, and you can look this up, that they're doing their best to try to mirror California, but they have stated that their regulations will not. It's not something that they can get in perfect harmony. So, they're trying, but we will not get there. They will not be the same, and the New York DFS has publicly admitted that. That's just going to be the state of play. We're being told that directly by the regulators, which I guess maybe that's helpful that they're not letting anyone confuse themselves on the front and that they're the same. They're telling us that they're not.

Chris Willis:

Yeah, we have no illusions of uniformity.

Joshua McBeain:

Correct. Exactly. Which, I mean, not helpful, but I guess maybe helpful that they're being honest with us.

Caleb Rosenberg:

Yeah. Some of it with the statutes were different, and so the regulator's boxed in a little bit, but the laws are very different. California and New York are relatively similar in using similar formats. But Virginia, for example, only applies to MCA but not other products. Virginia and Utah require registration where California and New York don't. Virginia, California, and New York have regulations where Utah has a very broad, open-ended statute. There's just differences. And there's proposed laws in other states like Missouri, New Jersey, Connecticut, North Carolina. Each of which have their own intricacies and differences. So, I would love to say that there'll be one single form that will be applied nationwide, but we're not there yet.

Joshua McBeain:

Well, in the registration point, I think that's a big deal because the consumer space, people that operate in that are familiar with registration and licensure and the burdens that come along with that. I mean, what does that practically mean if a year ago I was offering business financing in 50 states? What does it mean that Utah and Virginia now have that registration requirement?

Caleb Rosenberg:

The registration requirements in New York, in Virginia and Utah are not particularly burdensome. They're not as gruesome as, say, a consumer lending license. But more than anything else, it means that you are putting yourself on the mat with the regulator as someone who is offering that product in that state. And by doing that, you have to assume that the regulator is going to be looking for your disclosures and more generally looking at whether you're complying with the law of that state. So, the actual registration requirement may not be particularly burdensome, but it's preparing to operate in that state in a way that the regulator approves of that is potentially more problematic.

Joshua McBeain:

Interesting. I think the only thing I'll add on uniformity is Utah has a statute but no proposed regulations yet, so it differs from California and New York on that point. So, we'll have to continue to watch that, and there might be more to come from Utah in that regard.

Caleb Rosenberg:

Yeah. And in New York, we're still waiting on final regs, and so I think we'll be watching this very closely.

Chris Willis:

Gentlemen, we've been talking about the variations among these state laws and the headaches that those variations will cause commercial financing providers. I guess, in a classic case of let's be careful what we wish for, let me just ask the question. Would it be better to have a federal small business financing disclosure law?

Joshua McBeain:

I think saying, be careful what you wish for is very appropriate. In 2021, there was a Small Business Lending Disclosure Act, a bill in the house. It hasn't gone anywhere, so don't worry. I don't think it's coming anytime soon, but it is being discussed. What that said actually was the Truth and Lending Act, which is the primary consumer financing disclosure law, it applies to credit for consumer family or household purposes. This Small Business Lending Disclosure Act would add business lending for commercial purposes or business purposes to TILA, so an update in existing consumer disclosure law for commercial lending.

Would that be better? Listen, businesses just want rules of the road so they can operate, right? So, from that perspective, it would seem like the answer would be yes. It would seem easier to have one standard where all 50 states and US territories comply with it and move forward with

the rest of your lending business. I'm not sure that would necessarily happen. We have state laws now, and we've seen this in other spaces.

Last June, the CFPB came out and basically said they didn't believe strongly in federal preemption for the Fair Credit Reporting Act and state law disclosures. So, they took a similar position for a federal commercial lending disclosure law. What could happen is you'd have to comply with the federal law, and in all instances where a state law went further, like required additional disclosures, you would still need to comply with those in those states. That would be a large compliance burden and operational burden for the lenders that are operating in multiple states. That's why I think be careful what you wish for is very well said, Chris.

Chris Willis:

Yeah. And I think what you just described, Josh, about all it does is add another law on top, not replace the diversity of laws that we already have or may have in the future. That's very similar, I think, to what we're seeing play out on the consumer side with the CFPB taking very limited views of preemption and actively encouraging states to go further than federal laws in areas like credit reporting, for example. That was something the Bureau did last year.

Well, while we're on the topic of federal laws. You talked, Josh, about the proposed legislation that was in the House in 2021 that didn't go anywhere. Is there anything else going on at the federal level that small business financing providers need to be aware of?

Joshua McBeain:

There's a small business FTCPA, which is a debt collections law introduced as well. That hasn't gone anywhere, but what's most important right now is we are expecting any day the Dodd-Frank 1071 final rule to be published by the CFPB. For those that aren't familiar, that's a law that will update ECOA in Reg B to require data collection for small business lending. What exactly small business lending means under that is to be determined.

I think for those that are familiar with the Home Mortgage Disclosure Act or HMDA, this is a similar type requirement whereby when you take an application for small business landing credit, you need to acquire a bunch of data points, and then report that information to the CFPB. For those that are familiar with HMDA and reporting HMDA, it's a significant burden. The law 1071 is going to be extremely complex. I think the proposed rule was 900 pages, so I imagine the final rule is not going to be short. This literally could come out any day. So, when it does, we're going to obviously read it and we can update you. Caleb, do you have any additional thoughts on that?

Caleb Rosenberg:

I think that it is going to be very complicated for companies to implement. After implementing it though, people should think, "How is the data going to be used by the regulators?" And soon after this is implemented, I expect that there'll be fair lending enforcement actions based on the data that is being provided. It is only a reporting requirement, but you have to think about how that data will be used and how you're preparing to make sure that your data tells the story that you expect it to tell and that you want the regulators to reap. It'll be interesting developments going forward in the next year or so.

Chris Willis:

Well, gentlemen, I'm confident in promising our audience that when that final rule comes out, which as Josh said may be any day now, we're going to take a look at it as fast as we can read the 900 or 1,000 or however many thousands of pages the CFPB gives us. And we'll be releasing another podcast episode to tell everybody what we see in the final 1071 rule, so stay tuned for that.

Gentlemen, I think that's probably a good place to close our podcast today, so I want to thank both of you for being on and sharing your obviously immense experience and knowledge about the consumerization of small business lending with our audience.

And of course, thanks to the audience for listening in as well. Don't forget to visit our blog, consumerfinancialserviceslawmonitor.com, and hit that subscribe button so that you can get all of our daily updates on the goings on in the regulatory and litigation world in consumer finance. And while you're at it, visit us over at troutman.com and add yourself to our Consumer Financial Services email list so you can get notices of our webinars and the alerts that we put out on significant developments. And of course, stay tuned for a great new episode of this podcast every Thursday afternoon. Thank you all for listening.

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