

Payments Pros – The Payments Law Podcast

The Evolving Landscape of B2B Payments: Regulatory Trends and Financial Practices Explained

Host: Josh McBeain

Guest: Caleb Rosenberg

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Josh McBeain:

Welcome to another episode of [Payments Pros](#), a Troutman Pepper podcast focusing on the highly regulated and ever-evolving payments industry. This podcast features insights for members of our FinTech and payments practice as well as guest commentary from business leaders and regulatory experts in the payments industry. I'm Josh McBeain, one of the hosts of the podcast.

Before we jump into today's episode, let me remind you to visit and subscribe to our blog, TroutmanPepperFinancialServices.com. And don't forget to check out our other podcasts on troutman.com/podcasts. We have episodes that focus on trends that drive enforcement activity, digital assets, consumer financial services, and more. Make sure to subscribe to hear the latest episodes.

Today I'm joined by my colleague, Caleb Rosenberg, to discuss business to business payments, and the increase of state law requirements associated with certain types of payments. Caleb is a member of our firm's consumer financial services practice group and focuses his practice on helping federal and state charter banks, FinTech companies, finance companies, and licensed lenders navigate regulatory risks posed by state and federal laws aimed at protecting consumers and small businesses in the credit and alternative finance products industry.

Caleb, thank you for joining me today and I look forward to our conversation.

Caleb Rosenberg:

Yes, thanks for having me, Josh.

Josh McBeain:

Of course. Well, Caleb, in some, what I wanted to talk to you about was businesses are entitled to receive payments for accounts receivable or future sales, just the normal course of their business. These types of payments have become increasingly regulated over the past couple of years at the state level. I'm thinking of that specifically merchant cash advance, so MCAs and factoring. I guess, to kick it off, I'd love for you to describe what is an MCA? What is factoring? What is the difference? To just level set with for our listeners what we're talking about.

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Caleb Rosenberg:

Yes. So, in both cases, they're just ways of financing a business based on the revenue that the business expects to receive. In the case of factoring, which is the traditional model, financing, that goes back to Roman era, is if you're owed money from a specific company, for services that you've already performed, you can sell that receipt to financing company, a factor who buys it at discount, so you get the money up front, and then the factoring company collects from whoever owed you the money. So, it's a true sale of that receipt.

MCA is just a twist on that. MCA takes factoring, but instead of it being an identified specific receipt owed by a specific company, it's any future receipt that the business could earn in the future. Usually, this is credit card receipts. Someone will have a flow of funds coming from credit cards or flow funds into a bank, they're operating bank account, they don't know exactly where those are going to come from. So, maybe it's a barber shop and it's everyone who comes in for a haircut over the next few months. The MCA company will purchase a portion of those receipts, so that they'll say, "We'll buy 10% of your future revenue." And just like if after, they buy the discount. So, that MCA concept developed over time as well, and so now there's a variety of different options within MCA too.

Josh McBeain:

Interesting. In sum, you could say, factoring addresses payments that are already owed, sort of past tense. MCA are payments that may be owed in the future to a business. Is that a fair summary?

Caleb Rosenberg:

MCA is a sale of future receivables, and factoring is a sale of already owed receipts.

Josh McBeain:

Thanks, Caleb. Recently, as you know, we've seen a lot of activity at the state level in this space. Before we get into what that is, and what that regulation sort of entails, what changed in the marketplace that spurred all the state-level legislation and laws that have been passed. Is there been a shift? What's changed in this marketplace?

Caleb Rosenberg:

So, five or six years ago, Bloomberg did a series of articles on the MCA industry, and a variety of bad practices that were taking place there, and that caused legislators, especially in New York, but also in California to really hone in on the issues and try to protect businesses from some of the bad acts that were happening in that space. It also got some attention from Congress at the federal level, but only proposed bills.

So, after a number of hearings, California took action first and passed the disclosure law. New York then took action after that passing a disclosure law and a number of other states have followed. Utah, Florida, Georgia, Virginia, and Connecticut. So, this has really become kind of the consumerization of Small Business Finance. The protections are frequently what we'd see in consumer transactions, but without price caps. So, it's disclosure, issues, issues dealing with

broker and broker behavior. Because there are so many differences in the types of transaction in the commercial space, it can get very, very complicated very quickly.

Josh McBeain:

That's interesting, Caleb, that you said, sort of the consumerization of commercial finance. Based on, I think, how some of these state law disclosures appear, or the state legislators want them to appear, that's a very appropriate comparison. However, what's interesting is, would you describe factoring an MCA as credit or not?

Caleb Rosenberg:

I would not. This is the reason that business is healthy. Structured these financing products in this way is, so that they're outside of the usury and licensed lending laws that apply to credit transactions, and that's because the financing companies are taking a different risk than lending companies are. The MCA company only gets paid if the future receipts are actually earned by the company receiving the financing. A factor only gets paid if that third party actually pays the invoice.

So, there's different risks and there's different pricing. For decades and decades, these types of transactions have been clearly outside of the lending and credit regulation regimes that exist at the state level. The CFPB has taken issue with that approach, both in the rulemaking for 1071, and on the consumer side for ISAs. So, there is risk that these can be re-characterized, either on a one-off basis, or categorically by a regulator.

Josh McBeain:

Yes. I mean, it's really appropriate. Again, the consumerization, of commercial finance is appropriate comparison. But it's funny to me, and I think it is to you as well, that, although we're describing it that way, these products that we're talking about today are not traditionally credit products, but yet these states have looked to and been informed by consumer credit regulation, when they draft these bills, and they've passed this legislation. I mean, would you agree, based on – I know, you're familiar with the disclosures. Would you agree that's a first summary?

Caleb Rosenberg:

Yes, absolutely. It's difficult to make some of the disclosures because of that. So, a number of states required APR disclosure in these transactions where the main idea behind the transactions is that the person who owes payments doesn't owe them on a fixed schedule. They owe them only as the income is earned, which could be a week from now, or a month from now. So, calculating one of the interest rate or an APR when the term is unknown, and is deliberately variable isn't only very difficult, but it also can be deceiving to the person who's getting the financing, because the main advantage that the customer gets is this flexibility. If you give a certain number that says this is what the equivalent interest rate would be, if you paid within exactly a month, that is susceptible to the small businesses getting the financing, because it might not take a month to pay. It might take three months or five months without that person being in the fall. So, it can be very frustrating for financing companies.

Josh McBeain:

Yes. Sort of playing on that would also, I would imagine, as frustrating for finance companies, is the variability between these states. Because they don't all mirror each other. Correct?

Caleb Rosenberg:

Yes. That's absolutely correct. Just going on the APR example, California and New York do require an APR disclosure, while Utah, Florida, and Georgia do not. There's plenty of other variations, too. So, Connecticut, Virginia only apply to sales-based finance, like these MCA-type products that we're talking about, while California, New York, Florida, and Georgia apply more broadly to many types of commercial financing. So, even within states, like California applies to finance leases, which are leases where there's a nominal purchase price at the end, but not to "true leases".

So, it's just a bit of a mess, and you need to navigate it for every different type of transaction to make sure you know what it applies to, as you're going into it on front end.

Josh McBeain:

Yes. Not to mention to add on to that complexity, various exemptions and exclusions based on entity type, loan type, loan size –

Caleb Rosenberg:

Loan amount, financing amount.

Josh McBeain:

Yes. What have you. And you mentioned there, one of the things you said was in certain states, and we're not really discussing this today, but in certain states, these laws have applied to what we would traditionally consider commercial credit products as well. So, a traditional loan type product.

Caleb Rosenberg:

Yes, exactly. So, in some states, California is a great example of this. You can be subject to multiple regulatory regimes. The California licensed lender law applies to commercial loans. This new disclosure law also applies to commercial loans is similar with the open-end credit. And so, it's much like in the consumer space, they've created this web of regulatory issues that companies need to be aware of before shutting up a program.

Josh McBeain:

Caleb, thank you for joining me today. And thank you to our audience for listening to today's episode. Don't forget to visit our blog, [TroutmanPepperFinancialServices.com](https://www.TroutmanPepperFinancialServices.com), and subscribe so you can get the latest updates. Please make sure to also subscribe to this podcast via Apple Podcast, Google Play, Stitcher, or whatever platform you use. We look forward to next time.

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