January 15, 2021

Ms. Jocelyn Sutton
Executive Secretary
Bureau of Consumer Financial Protection
1700 G Street NW
Washington, DC 20552

Re: Preemption Request

Ms. Sutton,

This letter is a request for a preemption determination regarding a state law pursuant to 12 C.F.R. § 1026.28(a)(1), which provides that a "creditor, State, or other interested party may request the Bureau to determine whether a State law requirement is inconsistent." The Small Business Finance Association ("SBFA") is an interested party.

The SBFA is a non-profit advocacy organization dedicated to ensuring small businesses have access to working capital. Our member companies provide billions in commercial financing to small businesses across the country and offer many different and unique products. Recently, a number of states have proposed or enacted legislation pertaining to commercial financing.

In particular, New York has passed legislation, New York, Assembly Bill A10118A/Senate Bill S5470B, that would require the disclosure of an Annual Percentage Rate ("APR") and finance charge in various commercial financing transactions (the "New York Law").[1] On January 6, 2021, the New York legislature, due to negotiations with Governor Cuomo, introduced legislation, Senate Bill S898/Assembly Bill A979, which would provide additional amendments to the New York Law (the "Amendments").[2] However, the law includes different calculations for APR and different definitions for the term "finance charge" than those provided for in the Truth in Lending Act ("TILA"). We believe these differences will cause confusion for small business owners and consumers, and frustrate the purpose of TILA to ensure uniformity in financing disclosures. Accordingly, we believe the New York Law's use of APR and finance charge are preempted by TILA pursuant to 12 C.F.R. § 1026.28.

I. Truth In Lending Act Overview

[1] See Exhibit A attached hereto for a full copy of the enacted law. California passed a commercial financing disclosure law in 2019 that requires the regulator (the California Department of Financial Protection and Innovation) to decide whether APR should be used in the disclosures or whether some other unique annualized metric should be used. The state regulator has issued proposed regulations, but they are not yet final. The proposed regulations adopt "APR" and "finance charge" provisions; however, the terms "APR" and "finance charge" would mean something different than they do under TILA. If the regulator fails to resolve these issues when the final regulations are issued (we have asked them to follow the TILA definitions for these terms), the same preemption analysis addressed in this letter would apply. Similarly, New Jersey has scheduled a hearing on a commercial finance disclosure bill that also includes modified APR and finance charge disclosures which, if enacted, will raise the same preemption issues addressed in this letter.

[2] See Exhibit B attached hereto for a copy of Senate Bill S898.

TILA was enacted for the specific purpose of helping consumers compare the cost of credit for lending products with different terms. Prior to TILA, consumers were given various disclosures with various calculations for a multitude of products. There was no uniformity in the information disclosed, or how it was calculated, between products or states. In order to provide uniformity in disclosures for consumer products, TILA created certain carefully defined terms of art so that when a consumer saw such a term in a disclosure, the consumer would know exactly what it meant and could compare it to the identical term in another disclosure. The terms "APR" and "finance charge" are two of the most important such terms of art and have specific definitions, calculations and applications under TILA.

II. Preemption

The Supremacy Clause of the United States Constitution (U.S. Const. art. VI., § 2) establishes that when state law and federal law conflict, federal law preempts state law.[3] Preemption "may either be expressed or implied, and 'is compelled whether Congress' command is explicitly stated in the statute's language or implicitly contained in its structure and purpose."[4] If a state law is not explicitly preempted it can be preempted when the state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[5] Therefore, in the event a state law is not expressly preempted by a federal law, preemption may be implied.[6]

TILA includes an express preemption provision, which provides that TILA does not preempt state law unless the state law is "inconsistent with the provisions of this subchapter and then only to the extent of the inconsistency."[7] Regulation Z expands on TILA's statutory preemption provision as follows:

> . . . State law requirements that are inconsistent with the requirements contained in chapter 1 (General Provisions), chapter 2 (Credit Transactions), or chapter 3 (Credit Advertising) of the Act and the implementing provisions of this part are preempted to the extent of the inconsistency. A State law is inconsistent if it requires a creditor to make disclosures or take actions that contradict the requirements of the Federal law. A State law is contradictory if it requires the use of the same term to represent a different amount or a different meaning than the Federal law, or if it requires the use of a term different from that required in the Federal law to describe the same item.[8]

The Official Interpretations to Regulation Z ("Commentary") also explain that a state law is inconsistent with TILA if it contradicts TILA. State laws that contradict TILA include:

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[3] *Hines* v. *Davidowitz*, 312 U.S. 52, 66-67 (1941); *Crosby v. Nat'l Foreign Trade Council*, 530 U.S. 363, 372 (2000).
[4] *Gade v. Nat'l Solid Wastes Mgmt. Assn.*, 505 U.S. 88, 98 (1992).
[5] *Hines, supra*, at 67.
[6] *Geier v. American Honda Motor Co., Inc.*, 529 U.S. 861, 875 (2000).
[7] 15 U.S.C. § 1610(a)(1).
[8] 12 C.F.R. § 1026.28(a)(1).

i. A state law that requires use of the term finance charge but defines the term to include fees that the Federal law excludes.

ii. A state law that requires a label such as nominal annual interest rate to be used for what the Federal law calls the annual percentage rate.[9]

It is important to note that the Commentary expressly addresses the preemption of state laws that misuse the terms "APR" and "finance charge" in a manner inconsistent with their use in TILA. "APR" and "finance charge" are the two key cost comparison terms defined by TILA and must be more conspicuous than all other required disclosures (in most cases). They are more important than all other TILA disclosures. A finance charge or APR computation cannot differ from TILA's as that would "contradict the amount computed and disclosed under the federal law. [If] the same term is used for different amounts, the state disclosure would be preempted."[10]

Note also that the Commentary refers to "a state law" broadly, without limitation to certain types of state laws. The language is intentionally broad, to protect the value of the key terms of art that TILA created: APR and finance charge. In fact, state laws that impose finance charge or APR disclosures will face more scrutiny in a preemption analysis as these two terms have such significance under TILA. As the Federal Reserve Board stated when concluding a state law requiring APR and finance charge disclosures was preempted:

> finance charge or annual percentage rate disclosures . . . will be reviewed more strictly; since these disclosures are particularly significant, any contradiction of the corresponding federal disclosure would interfere with the intent of the federal scheme.[11]

A state law may also be preempted even if it does not contradict TILA in the specific manner described in Regulation Z. In those instances, it must be determined whether "the state law significantly impedes the operation of the federal law or interferes with the intent of the federal scheme."[12] The Board has made eight (8) separate TILA preemption determinations pursuant to this guidance.[13]

The plain wording of TILA and Regulation Z, and the above-referenced determinations, make clear that any state law mandating disclosures for consumer financing covered by TILA is preempted by TILA to the extent:

1. The term "Annual Percentage Rate" or "APR" is used but references a different amount than what TILA requires, or the law mandates a calculation different than what TILA requires.

[9] Supplement I Part 3 to 1026 (Comment 2 to 12 C.F.R. § 1026.28(a)).
[10] 47 Fed. Reg. 16203 (April 15, 1982).
[11] 47 Fed. Reg. 16202 (April 15, 1982).
[12] 48 Fed. Reg. 4454 (February 1, 1983).
[13] *Id.*; 55 Fed. Reg. 49396 (November 28, 1990).

2. The term "finance charge" is used but includes fees not included under TILA's definition of "finance charge," or excludes fees included under TILA's definition of "finance charge."
3. The law requires a TILA closed-end credit APR calculation for an open-end credit product, instead of using the TILA open-end credit APR calculation.

To highlight why TILA preemption is so critical, consider whether a state law could mandate a unique APR disclosure for a consumer credit product that is not subject to TILA. More specifically, would TILA preempt a state law that requires all unsecured consumer loans over the TILA monetary threshold to disclose the "APR," but defines "APR" using the simple interest rate and not the APR calculation required under TILA? If such a law is not preempted, consumers would be provided two different "APRs" for essentially the same financing product, where the only difference in the loans is their amounts (which may vary by as little as a penny). This would obviously cause significant confusion and impede the goal of TILA to ensure uniformity in consumer finance disclosures. This hypothetical demonstrates that the value in defining "APR" and "finance charge" as consistent terms of art lie in enforcing their definitions beyond the specific credit products that are subject to TILA. The alternative – allowing the terms to be used inconsistently in different products – degrades the purpose of consistent, uniform terms: ensuring that consumers always know what the terms mean and can thus fairly compare financing options across product lines.

The specific question presented by this letter is whether the New York Law provisions that mandate disclosure of terms called "APR" and "finance charge" but define and calculate those terms differently than is done in TILA should be preempted, even though the state law applies to financing products not subject to TILA (*i.e.* commercial finance products).[14] In considering this question, it is important to remember that small business owners often finance their businesses through a combination of commercial loans (and similar products) and consumer finance products (*e.g.* consumer loans, home equity loans, consumer or business credit cards). Consequently, when such business owners shop for financing, they routinely compare products that are subject to TILA to products that are not subject to TILA. A state law mandating disclosure of two essential TILA-defined terms for non-TILA products, but defining or calculating those terms differently from TILA, will create significant confusion among consumers considering TILA products. This inconsistency will result in misleading disclosures of credit choices, thwarting Congress' primary objective in enacting TILA.

III. The New York Law

The New York Law was passed by the New York legislature in July of this year and signed by the governor on December 23, 2020. It requires a broad set of disclosures for various types of commercial financing products, including loans, lines of credit, factoring transactions, merchant cash advances, and other forms of commercial financing. It appears to require the disclosures to

[14] TILA generally does not apply to commercial financing. Since the original creation of TILA in 1968, Congress and the applicable federal regulators have often considered whether TILA should be expanded to apply to commercial transactions, but they have repeatedly declined to do so. Most recently, in 2010 the Federal Reserve Board studied this issue and concluded that TILA's disclosure provisions should not be expanded to apply to small business credit cards (as it was not clear if the benefits would outweigh the costs).

be provided early in the negotiation process and given multiple times prior to consummation of a transaction. For purposes of this letter, the relevant provisions of the New York Law are those that use the terms "APR" and "finance charge." The New York Law utilizes the TILA terms "APR" and "finance charge," yet it alters their definitions and applies them to commercial transactions. Moreover, it creates an estimated APR and provides a wholly novel method for calculating the amount, mixing Regulation Z requirements with new requirements. When signing the law, New York Governor Cuomo stated that he had negotiated with the legislature to make changes to align the New York Law to "existing requirements under Federal Laws, including the Truth in Lending Act,"[15] which negotiations resulted in the Amendments that were introduced on January 6, 2021. However, as explained below, this is simply not the case. The New York Law adopts the terms "APR" and "finance charge", but then redefines them in such a way that the disclosed amounts and rates required under the New York Law will not mirror the disclosed amounts and rates a consumer would receive in a comparable TILA-covered consumer credit transaction. This will obviously cause substantial confusion and undermine Congress's intent in enacting TILA.

IV. Provisions of New York Law Related to This Preemption Request

The New York Law requires the disclosure of a "finance charge," an "Annual Percentage Rate" or "APR," and a newly created "Estimated APR." Additionally, the New York Law requires that TILA closed-end APR disclosures be provided for open-end commercial financing instead of TILA open-end APR disclosures.

Finance Charge: "Finance charge" is defined differently in the New York Law compared to TILA. "Finance charge" in the New York Law is defined as "the cost of financing as a dollar amount. It includes any charge payable directly or indirectly by the recipient and imposed directly or indirectly by the provider as an incident to or a condition of the extension of financing."[16] While the apparent intention of the New York Law was to have its definition of finance charge in the New York Law mirror the TILA definition, it fails to do so. Under the New York Law, "finance charge" includes fees imposed by a "provider."[17] "Provider" is defined to include any person that extends a specific offer of commercial financing but also includes any "person who solicits and presents specific offers . . . on behalf of a third party."[18] Accordingly, the definition of provider includes not just creditors but also brokers and arrangers of commercial credit. As a result, not only are charges imposed directly or indirectly by a creditor included in the "finance charge" (which is consistent with TILA), but so are charges imposed directly or indirectly by an arranger of credit or broker (this is much broader than TILA, and a similar provision was removed from TILA decades ago).[19] This will cause material confusion as the definitions are not the same and what is included in the "finance charge" is not identical.

[15] See New York Governor's Approval Memo attached hereto as Exhibit C.
[16] N.Y. Financial Services Law § 801(e).
[17] *Id*.
[18] *Id*.
[19] Under TILA, certain broker fees in non-real property transactions are treated as finance charges if the creditor requires use of the broker. However, under the New York Law all brokers fees are included as finance charges even if not required by the creditor and even if the transaction is not secured by real property.

Estimated APR and APR: The New York Law requires all commercial financing products subject to the law to disclose an APR or Estimated APR. For closed-end financing and open-end financing, the New York Law requires an APR to be disclosed but for sales-based financing and factoring transactions an Estimated APR must be disclosed.[20] When referring to the APR, the New York Law provides that the APR must be "calculated in accordance with the federal Truth in Lending Act, Regulation Z, 12 C.F.R. § 1026.22,"[21] and the proposed Amendments would add the phrase "regardless of whether such act or such regulation would require such a calculation."[22] When referring to the Estimated APR, the New York Law provides that the Estimated APR must be "calculated in accordance with the federal Truth in Lending Act, Regulation Z, 12 C.F.R. § 1026.22, based on the estimated term of repayment and the projected payment amounts,"[23] and the proposed Amendments would add "regardless of whether such act or such regulation would require such a calculation."[24]

The New York Law, however, fails to recognize the problem that its definition of "finance charge" creates for the APR calculation. Finance charge and APR calculations go hand in hand. If the finance charge amount changes, the APR changes.

By including fees in the finance charge that TILA excludes from the finance charge, the New York Law will result in an APR calculation that differs from the calculation mandated by TILA for consumer credit transactions. For example, broker fees that are excluded from TILA's definition of "finance charge" are included in the "finance charge" under the New York Law (since all broker fees are included in the "finance charge" under New York Law). As a result, the New York Law "finance charge" amount disclosed may be higher than TILA's (in a comparable consumer credit transaction), and the result would yield a higher APR than what is instructed by the federal law.

Additionally, the Estimated APR disclosure in the New York Law will cause confusion as TILA requires that APR be calculated using a precise mathematical calculation based on actual payment amounts and timing. However, the New York Law requires that creditors who offer products with no fixed terms and no fixed payment amounts make broad assumptions about terms and payment amounts in order to calculate and disclose an "Estimated APR."[25]

Estimated APR can only be imprecisely calculated for financial products that have no fixed term or fixed payment amount because customers may end up remitting payments for a longer or shorter time period than originally anticipated. TILA's goal of providing consumers with a precise APR will be frustrated as small business owners subjected to Estimated APR will come to view such disclosures as merely a guess on costs based on broad assumptions. This, in turn, will make them wary of relying on APR disclosures when they use consumer credit products to finance their business operations.

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[20] N.Y. Financial Services Law §§ 803(c), 804(c), 805(c), 806(c).
[21] N.Y. Financial Services Law §§ 804(c), 805(c).
[22] 2021 N.Y. SB 898 §§ 804(c), 805(c).
[23] N.Y. Financial Services Law §§ 803(c), 806(c).
[24] 2021 N.Y. SB 898 §§ 803(c), 806(c).
[25] N.Y. Financial Services Law §§ 803(c), 806(c).

Finally, the New York Law requires creditors to make certain assumptions about payment amounts and payment frequencies when calculating APR and Estimated APR. These assumptions are different than the assumptions required under TILA. Accordingly, these payment amount and frequency assumptions will cause further differences in APR and Estimated APR disclosures under the New York Law when compared to APR disclosures under TILA.

Use of Closed-End APR for Open-End Products: The New York Law applies commercial financing disclosures to certain types of financial products, including "open-end financing," which is defined as "an agreement for one or more extensions of open-end credit . . . ." where the commercial financing company "reasonably contemplates repeated transactions."[26] The definition of open-end financing in the New York Law is almost identical to TILA's definition of "open-end credit" in Regulation Z, 12 C.F.R. § 1026.2(a)(2).

However, the New York Law inexplicably prohibits the use of TILA's open-end APR calculation. Specifically, the open-end product disclosure requirements under the New York Law provide that the APR must be "calculated in accordance with the federal Truth in Lending Act, Regulation Z, 12 C.F.R. § 1026.22 and based on the maximum amount of credit available to the recipient and the term resulting from making the minimum requirement payments term as disclosed, regardless of whether such act or such regulation would require such a calculation."[27] As you are aware, 12 C.F.R. § 1026.22 is part of Subpart C of Regulation Z and applies only to closed-end credit. Open–end credit disclosures and open-end APR calculations under TILA are governed by Subpart B of Regulation Z. Accordingly, the New York Law requires a closed-end credit APR calculation for an open-end credit product and prohibits an open-end APR disclosure that would be consistent with TILA's open-end APR rules.

The SBFA believes that the above provisions of the New York Law are preempted by TILA. The New York Law is inconsistent with TILA and its purposes. Furthermore, the New York Law creates an obstacle to Congress' objectives in enacting TILA: to create a uniform credit disclosure and terms of art, so that when a consumer saw the term "APR" or "finance charge" he/she would without hesitation understand what the terms mean and therefore be able to rely on them when shopping for credit. The New York Law stands in direct conflict with Congress' goal to establish APR and finance charge as terms of art for consumer credit transactions that cannot be modified by state law. If a small business owner (who is a consumer when applying for personal credit) is looking for commercial financing and is provided with the New York Law disclosure, he/she will incorrectly assume that the "APR" and "finance charge" being disclosed are calculated the same way as they were for the owner's personal unsecured bank loan. If the inconsistencies in the New York Law are not preempted, these provisions will cause confusion for small business owners and weaken the value of TILA's APR and finance charge disclosures. As more states adopt similar laws and commercial finance companies advertise and market nationally, it is possible there could be 50 different versions of finance charge and APR further confusing both consumer and commercial borrowers. Without a determination that TILA preempts any attempt by a state to redefine APR or finance charge even for non-consumer credit transactions, states will be free to decide what they want included in the definition of finance charge and how to calculate APR, with

[26] N.Y. Financial Services Law § 801(c).
[27] N.Y. Financial Services Law § 805(c).

each state potentially reaching a different conclusion. It is easy to envision numerous different definitions of finance charge and many different calculations of APR, all being advertised on a national level to reach small business owners. This will certainly weaken the value of having a uniform definition of "finance charge" and APR calculations in the consumer credit context, thereby making them less reliable. The New York Law provisions identified above must be preempted to protect the value and reliability of TILA's "finance charge" and APR disclosure requirements.

Please note that the SBFA is not arguing that New York cannot regulate or require disclosures for commercial finance products. Nor is the SBFA arguing that New York cannot require disclosure of fees or mandate an annualized metric. We are simply arguing that New York cannot mandate the use of the terms "finance charge" and "APR," which are carefully-defined terms of art under TILA, and then define them differently from TILA.

The SBFA and our members greatly appreciate your consideration of our request. We are happy to answer any questions you may have.

Respectfully,

Stephen Denis
CEO, Small Business Finance Association

Attachments
1. Exhibit A- NY Law
2. Exhibit B- NY Law Amendments