

Department of Legislative Services
Maryland General Assembly
2023 Session

FISCAL AND POLICY NOTE
Third Reader - Revised

Senate Bill 496
Finance

(Senator Kramer)

Economic Matters

Commercial Financing Transactions

This bill establishes a regulatory framework for businesses that engage in commercial financing transactions. Specifically, the bill establishes requirements related to disclosures, annual percentage rate (APR) calculations, repayment terms, and other related items, as well as the extension of special offers. The Office of the Commissioner of Financial Regulation (OCFR) within the Maryland Department of Labor must adopt regulations to implement the bill.

Fiscal Summary

State Effect: General fund revenues may increase minimally due to the bill’s civil penalty provisions, as discussed below. Implementation and related enforcement can likely be handled with existing resources.

Local Effect: None.

Small Business Effect: Meaningful.

Analysis

Bill Summary: The bill authorizes the Nondepository Special Fund to be used to cover the costs of implementing the bill’s requirements.

Definitions

The bill defines “commercial financing” as a type of financing that encompasses “open-end financing,” “closed-end financing,” “sales-based financing,” a “factoring transaction,” or another form of financing. Those types of financing are defined as follows:

- “open-end financing” means an agreement for one or more extensions of open-end credit (secured or unsecured). This includes credit extended by a provider (*i.e.*, the person extending a financing offer) under a plan in which (1) the provider reasonably contemplates repeated transactions; (2) the provider may impose a finance charge on an outstanding unpaid balance; and (3) the amount of credit that may be extended during the term of the plan is generally made available to the extent any outstanding balance is repaid;
- “closed-end financing” means a closed-end extension of credit (secured or unsecured), including equipment financing, that does not meet the definition of a lease under the Uniform Commercial Code;
- “sales-based financing” means a transaction that is repaid by a recipient to a provider over time as a percentage of sales or revenue, in which the payment amount may increase or decrease according to the volume of sales made (or revenue received) by the recipient; and
- a “factoring transaction” is an accounts receivable purchase transaction that includes an agreement to purchase, transfer, or sell a legally enforceable claim for payment held by a recipient for goods the recipient has supplied or services the recipient has rendered that have been ordered but for which payment has not been made.

In all cases, the recipient must *not* intend to use the proceeds primarily for personal, family, or household purposes.

Applicability Provisions

The bill specifies entities and activities that are excluded from regulation, including a federal or State bank, credit union, or savings association (or a subsidiary or affiliate of such entities), commercial financing transactions for more than \$2.5 million, commercial financing transactions related to vehicle dealers or rental vehicle companies, and certain commercial financing transactions related to accounts receivable owed to a health care provider.

Contingent Exemptions

Under certain circumstances, the bill does not apply to (1) an entity principally engaged in the business of making commercial financing products in connection with the purchase or lease of products manufactured or distributed by its direct or indirect parent company (or any direct or indirect subsidiary of the parent company) or (2) a purchase-money obligation as defined in specified provisions of the Maryland Uniform Commercial Code.

However, these additional exemptions are contingent upon the adoption of similar exemptions through regulation by the New York State Department of Financial Services.

Within 10 days after any such regulations are adopted by New York State, OCFR must notify the Department of Legislative Services (DLS). If notice of the adoption is received by DLS by September 30, 2024, the additional exemptions noted above become effective on the date the notice is received. Conversely, if notice of the adoption is *not* received by September 30, 2024, then the additional exemptions are null and void.

Method of Calculating Annual Percentage Rates

Generally, the bill requires an APR to be (1) expressed as a yearly rate, including all fees and finance charges and (2) calculated in accordance with the federal Truth in Lending Act. In addition, an APR must be calculated based on the estimated term of repayment and the projected periodic payment amounts of a commercial financing transaction, regardless of whether federal law or regulation would require an APR to be calculated for a certain transaction. Additional requirements apply depending on the type of commercial financing.

For sales-based financing transactions, a provider must inform OCFR how it intends to calculate the estimated APR of each sales-based financing transaction. By January 1 each year, a licensee that elects to use a specified method must report to OCFR on (1) the estimated annual APR given to each recipient and (2) the actual APR of each completed sales-based financing transaction. If OCFR finds there was an unreasonable deviation between estimated and actual APRs of sales-based financing transactions, the licensee may be required to use a different method to determine projected sales volume.

Required Disclosures

The bill establishes numerous disclosure requirements that apply to each type of financing. Although specific requirements differ based on the financing type, generally, the bill requires a provider to disclose certain information to a recipient when extending a specific offer (*e.g.*, the total amount financed and disbursement amount, the finance charge, the estimated APR, etc.). Additional disclosures regarding payment amounts apply depending on whether the payments are fixed or variable, or if a recipient pays off or refinances before the end of the scheduled repayment period. Similar requirements apply for other specific offers.

Required Pay Offs

A provider may require a recipient to pay off the balance of an existing commercial financing transaction from the same provider as a condition of obtaining a new or renewal commercial financing transaction. In such cases, the provider must disclose (1) the amount of the new or renewal commercial financing that will be used to pay off the portion of the existing financing that consists of any required prepayment charges and (2) any unpaid interest that was not forgiven at the time the new financing was entered into. The bill

stipulates the manner in which the prepayment charge must be calculated. If the disbursement amount of the new or renewal financing transaction will be reduced to pay down any unpaid portion of the outstanding balance, the provider must disclose the actual dollar amount by which the disbursement amount will be reduced.

Signature

A recipient must sign each applicable disclosure before a provider may allow the recipient to proceed with the commercial financing application.

Additional Disclosures

If a provider provides an additional disclosure, the additional disclosure is not considered a required disclosure (*i.e.*, as required by the bill). The bill specifies the manner in which an additional disclosure must be presented.

Regulations

The regulations adopted by OCFR must be substantially the same as regulations adopted by the New York State Department of Financial Services regarding commercial financing. OCFR must also approve the use of commercial financing disclosure forms approved for use in other states with requirements that are substantially similar to (or exceed) the bill's requirements.

Enforcement Provisions

OCFR must impose a civil penalty of up to \$2,000 for each violation of the bill and \$10,000 for each willful violation of the bill. Any such civil penalties accrue to the general fund. Additionally, OCFR may order additional relief, including restitution or a permanent or preliminary injunction on behalf of a recipient affected by a violation of the bill. Further, if a complaint is filed about a violation of the bill, OCFR may investigate the complaint and use any of the investigative and enforcement powers provided under State law.

Current Law: OCFR has the power to vigorously investigate financial transactions to determine whether a person has violated a law, regulation, rule, or order over which the commissioner has jurisdiction. For the purposes of an investigation or proceeding, the commissioner may administer oaths and affirmations, subpoena witnesses, compel the attendance of witnesses, and require the production of documents and other evidence. If a person refuses to obey a subpoena from the commissioner, the commissioner may apply to the appropriate circuit court to issue an order requiring the person to appear before the commissioner and produce any requested evidence. If the court issues such an order, failure to obey it subjects the person to contempt of court.

When the commissioner determines, after notice and a hearing, as specified, that a person has engaged in a violation of a law, regulation, rule, or order, the commissioner may issue a cease and desist order, suspend or revoke the license of the violator, and/or issue a penalty order against the person for up to \$10,000 for a first violation and up to \$25,000 for each subsequent violation.

State Fiscal Effect: Although OCFR indicates that it may need additional staff in order to implement the bill's requirements, DLS notes that, due to the uncertainty of how many entities in the State may be subject to the bill, OCFR can likely accommodate any short-term workload increase with existing resources. The bill does not include any licensing or registration requirements, and it includes numerous exemptions from its provisions, so it is unclear how many commercial lenders are affected by the bill. To the extent that there are significantly more entities in the State than expected over multiple years (and many additional complaints), OCFR may need to hire additional staff, particularly due to the provisions of the bill that require monitoring of similar regulatory activities undertaken by New York State.

The Judiciary can handle any increase in caseloads (likely minimal) with existing resources.

Any impact on general fund revenues (due to OCFR civil penalty provisions) is also expected to be minimal.

Small Business Effect: OCFR noted for a prior introduction of the bill that the product standards and lending requirements established by the bill may benefit small businesses by allowing them to borrow in a transparent and affordable manner. However, the commercial lenders subject to the bill's requirements may incur additional compliance costs, to the extent such lenders are small businesses based in the State. However, any such impact cannot be reliably determined without additional information (*e.g.*, the number of lenders in the State affected by the bill, the regulations adopted by New York State and subsequently adopted in Maryland, etc.).

Additional Information

Prior Introductions: Similar legislation has been introduced within the last three years. See SB 825 of 2022.

Designated Cross File: None.

Information Source(s): Office of the Attorney General (Consumer Protection Division); Maryland Department of Labor; Department of Legislative Services

Fiscal Note History: First Reader - February 13, 2023
rh/mcr Third Reader - March 24, 2023
Revised - Amendment(s) - March 24, 2023

Analysis by: Eric F. Pierce

Direct Inquiries to:
(410) 946-5510
(301) 970-5510