Department of Legislative Services

Maryland General Assembly
2021 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 532 (Senator Kramer)
Finance

Financial Institutions - Consumer Credit - Sales-Based Financing Transactions

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This bill establishes a regulatory framework for businesses that engage in "sales-based financing transactions," which the bill defines as financing transactions that are repaid over time as a percentage of sales or revenue (where the payment amount may increase or decrease depending on the volume of sales made or revenue received by the recipient). The Office of the Commissioner of Financial Regulation (OCFR) within the Maryland Department of Labor must oversee the licensing and regulation process of any entities engaged in these types of activities. The bill prohibits a person from engaging in the business of making (or soliciting) sales-based financing transactions unless the person is licensed according to the bill's requirements. OCFR must adopt regulations to carry out the bill's requirements. Violation of the bill is an unfair, abusive, or deceptive trade practice under the Maryland Consumer Protection Act (MCPA), subject to MCPA's civil and criminal penalty provisions.

Fiscal Summary

State Effect: Special fund revenues increase beginning in FY 2022, as discussed below. General fund revenues increase, potentially minimally, beginning in FY 2022 due to the bill's penalty provisions. Implementation and related enforcement can likely be handled with existing resources.

Local Effect: The bill does not materially affect local government finances or operations.

Small Business Effect: Meaningful.

Analysis

Bill Summary:

Definitions, Applicability, and Licensing Requirements

The bill specifies entities and activities that are excluded from regulation, including insurance companies, State-licensed financial institutions, and individual commercial financing transactions over $500,000. The bill also establishes licensing procedures, requirements, and qualifications as well as provisions related to the confidentiality of information for licensees. An application for a license is $850, which is refundable if the applicant is found not to be eligible for a license; applicants must also pay a nonrefundable $100 investigation fee. A license may be renewed annually; the renewal fee is also $850. Licensing revenues (as well as any other fee or revenue received by OCFR under the new sales-based financing subtitle) must be deposited into the Nondepository Special Fund and used for related purposes. However, OCFR must pay all fines and penalties into the general fund.

Recordkeeping Requirements

The bill establishes recordkeeping requirements for licensees; a licensee must retain the appropriate records for at least two years. At any time, OCFR may investigate the records and business operations of a licensee (or a person who acts on behalf of a licensee). OCFR may also subpoena documents (or other evidence) and may summon (and examine) under oath any person whose testimony is required.

Enforcement

OCFR may enforce the bill's requirements by issuing an order (1) to cease and desist from a violation and any further similar violations and (2) requiring the violator to take affirmative action to correct the violation (including restitution of money or property to any aggrieved person). OCFR may also impose a civil penalty in an amount of up to (1) $10,000 for each violation and (2) $25,000 for each violation from which the violator failed to cease and desist (or for which the violator failed to take affirmative action to correct). OCFR must consider specified factors (*e.g.*, the seriousness of the violation) when determining the amount of any penalty imposed.

OCFR may suspend or revoke the license of any licensee who engages in illegal or otherwise dishonest activities or violates the provisions of the sales-based financing transactions subtitle, as specified. However, prior to taking any enforcement actions, OCFR must give the licensee an opportunity for a hearing in accordance with State law.

The bill prohibits a licensee from directly (or indirectly) advertising, printing, displaying, publishing, distributing, or broadcasting a false, misleading, or deceptive statement regarding the rates, terms, costs, or conditions of a sales-based financing transaction.

A person who violates the provisions related to the licensure and regulation of sales-based financing companies is guilty of a misdemeanor and, upon conviction, is subject to a fine of up to $5,000 and/or imprisonment for up to three years. In addition, the person is subject to the enforcement and penalty provisions of MCPA.

OCFR has sole authority to enforce the bill's requirements. The bill may not be construed to create (or authorize) a private right of action against a person based on compliance (or noncompliance) with the bill's requirements.

Calculation of Repayment Term and Annual Percentage Rate

The bill specifies the manner in which a licensee must calculate certain information related to sales-based financing transactions (*e.g.*, by using the projected sales volume of a recipient to calculate the term of repayment, the annual percentage rate (APR), etc.). A licensee must inform OCFR how it intends to calculate the estimated APR of each sales-based financing transaction. By January 1 each year, a licensee 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.

Disclosure Requirements

Each licensee must disclose specified information (as required by OCFR) at the time it extends an offer of a sales-based financing transaction. Specifically, a licensee must disclose to a recipient:

- the total amount of funds provided;
- the estimated APR of the transaction;
- the term (or estimated term);
- the method, frequency, and amount of payments;
- fees charged (and chargeable);
- a complete copy of the financing agreement; and
- a description of collateral requirements or security interests (if applicable).

If the recipient pays off (or refinances) the sales-based financing transaction before the end of the scheduled repayment period, the licensee must disclose additional information, as specified.

The bill authorizes a licensee to require a recipient to pay off the balance of an existing sales-based financing transaction as a condition of obtaining a new sales-based financing transaction. However, any business that makes this a requirement must disclose additional information, including (1) the amount of the *new* sales-based financing that will be used to pay off any required prepayment charges and (2) any unpaid interest that was not forgiven at the time the new sales-based financing transaction was entered into. The bill specifies how a prepayment charge must be calculated and reported.

Prohibited Activities

The bill prohibits a licensee from (1) taking a confession of judgment or a power of attorney authorizing the licensee (or a third party) to confess judgment or to appear for the recipient in a judicial proceeding; (2) taking a negotiable instrument from a recipient in which blanks are left to be filled in after contract execution; or (3) entering into a sales-based financing transaction with an estimated APR that exceeds 24%.

Current Law: Sales-based financing transactions are not regulated by Maryland law.

Maryland Consumer Protection Act

An unfair, abusive, or deceptive trade practice under MCPA includes, among other acts, any false, falsely disparaging, or misleading oral or written statement, visual description, or other representation of any kind which has the capacity, tendency, or effect of deceiving or misleading consumers. The prohibition against engaging in any unfair, abusive, or deceptive trade practice encompasses the offer for or actual sale, lease, rental, loan, or bailment of any consumer goods, consumer realty, or consumer services; the extension of consumer credit; the collection of consumer debt; or the offer for or actual purchase of consumer goods or consumer realty from a consumer by a merchant whose business includes paying off consumer debt in connection with the purchase of any consumer goods or consumer realty from a consumer.

The Consumer Protection Division within the Office of the Attorney General (OAG) is responsible for enforcing MCPA and investigating the complaints of aggrieved consumers. The division may attempt to conciliate the matter, issue a cease and desist order, or file a civil action in court. A merchant who violates MCPA is subject to a fine of up to $10,000 for each violation and up to $25,000 for each repetition of the same violation. In addition to any civil penalties that may be imposed, any person who violates MCPA is guilty of a misdemeanor and, on conviction, is subject to a fine of up to $1,000 and/or imprisonment for up to one year.

State Fiscal Effect: OCFR notes that the bill's requirements (*i.e.*, the licensing and supervisory structure) are similar to those for consumer loan licensees, which is expected to ease implementation of the bill. Although the bill specifies the licensing and investigation fees for prospective licensees, OCFR is unable to identify how many entities may apply for licensure under the bill. While the exact impact on Nondepository Special Fund revenues cannot be determined at this time, any impact is assumed to be minimal. Any impact on general fund revenues due to the bill's penalty provisions is also expected to be minimal.

Although OCFR indicates it may need additional staff in order to process and oversee the new licensing scheme, the Department of Legislative Services notes that, due to the uncertainty of how many entities may apply for licensure, OCFR can likely accommodate any short-term influx of applications with existing resources. To the extent that there are significantly more applicants than expected over multiple years, OCFR may need to hire additional staff.

The Office of Administrative Hearings, the Judiciary, and OAG can handle any increase in caseloads (likely minimal) with existing resources.

Small Business Effect: OCFR advises that a sales-based financing transaction (as defined in the bill) can be considered a subset of a commonly used source of business financing known as factoring. In a factoring transaction, the seller is typically a merchant that has sold a good or service, holds the resultant account receivable, and then sells that receivable at a discount to a third party for cash. The party obligated on the receivable then pays its obligation to the third-party purchaser. OCFR further notes that factoring has been a part of commerce since Mesopotamian times and is widely available in Maryland and throughout the United States.

Sales of accounts receivable are used by firms to obtain cash, typically in circumstances when their cash balance is insufficient to meet immediate or short-term cash needs. For example, companies may, from time to time, need cash to purchase inventory or goods, or to enter into contracts, and they face an imbalance between the time in which they expect their receivables to be paid (*i.e.*, converted to cash) and their more immediate need to make payments. OCFR further advises that small businesses are likely to engage in these types of transactions, as they accept credit card payments and those receivables are their greatest source of liquidity.

The product standards, licensing, and regulatory structure established by the bill may provide more small businesses the ability to utilize sales-based financing products in a transparent and affordable manner. However, because the bill establishes a maximum APR for these types of commercial transactions (a limitation that has typically been established for consumer products), OCFR notes this could limit the accessibility of the product. Such restrictions could discourage small business lenders from establishing operations in Maryland or from providing services to Maryland businesses.

Additional Comments: As introduced, the bill excludes from regulation a financing transaction in which the recipient *does not* intend to use the proceeds primarily for personal, family, or household purposes. As this provision excludes all business transactions from regulation, it seems likely that the intent is to exclude transactions in which the proceeds *are* intended to be used primarily for personal, family, or household purposes. This analysis is based on that assumption.

Additional Information

Prior Introductions: None.

Designated Cross File: HB 664 (Delegate Howard) - Economic Matters.

Information Source(s): Judiciary (Administrative Office of the Courts); Maryland Department of Labor; Office of Administrative Hearings; Department of Legislative Services

Fiscal Note History: First Reader - February 16, 2021
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