



North Dakota Law Regulates “Alternative Financing” as a “Loan”

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The state legislature in North Dakota recently passed House Bill 1127. This bill made a simple amendment to a 1970s-era law called the Money Brokers Act (“MBA”).

Despite its name, the MBA is not limited to brokers. It is the primary law regulating consumer and commercial lending in North Dakota. It applies to any person engaged in the act of arranging or providing loans. Such persons are called “money brokers” in the MBA.

This amendment adds a two-sentence definition of the word “loan”. When this amendment takes effect, the MBA will define “loan” as follows:

“Loan” means a contract by which one delivers a sum of money to another and the latter agrees to return at a future time a sum equivalent to that which the person borrowed. This includes alternative financing products as identified by the commissioner through the issuance of an order.

Is this is a big deal? Yes. Here’s why.

Until now, the MBA has always defined the term “money brokering” to include the act of providing “loans” but has never defined the term “loan”. As a result, forms of business financing that are not typically considered loans – such as factoring or revenue-based financing (also sometimes called “merchant cash advance”) would not be subject to the MBA. Adding this new definition of “loan” to the MBA creates significant risk that alternative forms of business financing will become subject to the regulatory burdens impose by MBA.

Those burdens are significant. The MBA requires money brokers to obtain a license from the North Dakota Department of Financial Institutions (“DFI”). The MBA also caps the maximum amount of fees and charges that can be impose by a money broker at a rate of 36% per year.

With this new definition, the North Dakota Department of Financial Institutions (“DFI”) can now issue an order designating any financing product as a loan subject to the MBA. Does the DFI intend to regulate revenue-based financing? That’s unknown at this time. The Commissioner of Financial Institutions provided a memorandum to the legislature stating that the new definition would allow DFI to ensure that North Dakota’s citizens “will have access to new lending products, without sacrificing safeguards”. It is possible that the Commissioner is intending to focus on consumer financing products and not commercial financing. Even if that’s the case, that’s small

comfort.

There is still a problem with this law because the first sentence of the definition is simply too broad. It states that a “loan” includes a transaction with the following two features:

- *There is a contract by which a sum of money is delivered to another.*
 - A typical revenue-based financing is structured as a purchase of a merchant’s future revenue at a discounted purchase price. The purchase price is a sum of money delivered to the merchant.
 - Invoice factoring transactions also involve a delivery of funds in the amount of the face value of the invoice minus a discount and/or a reserve.
- *At a future time, the person receiving that money agrees to return an “equivalent” sum.*
 - In revenue-based financing, the merchant agrees to deliver the purchased amount based on an agreed-upon percentage of the merchant’s revenue stream. Arguably this is a “sum of money” equivalent to the purchase price advanced to the merchant.
 - Factoring is a bit more complicated. In recourse factoring, a factoring client sometimes is required to repurchase an invoice from the factor if the invoice is not paid on time. The repurchase price is based on the face value of the invoice. Arguably this is a “sum of money” equivalent to the face value of the invoice minus a discount and/or a reserve.

Even if the DFI does not order that revenue-based financing or factoring are loans, a North Dakota court could take the position that the definition of “loan” is now so broad that these products are already loans under the revised MBA. No DFI order is needed.

If a North Dakota court concludes these products are now subject to regulation under the MBA, including its 36% rate cap, then this opens the door for North Dakota businesses that obtain financing to sue any provider that imposes charges that effectively exceed that rate cap.

It’s not clear whether the North Dakota legislature understands what it just did. This amendment was part of a legislative package that was primarily focused on data security. The addition of the “loan” definition would be difficult to find if you weren’t looking for it. House Bill 1127 passed with almost unanimous support. Did all those legislators understand that this law could drive away products that offer working capital to businesses that badly need liquidity and don’t have access to a bank line of credit? I doubt it.

Does this mean that providers of alternative financing should stop funding in North Dakota? That’s a business decision. We’ll certainly be watching to see if the DFI provides any guidance on any kind of “alternative financing” product it considers to be a loan. But providers of revenue-based financing and factoring should start thinking about whether they might need an MBA license North Dakota and whether they can live with the MBA’s 36% rate cap.

According to the North Dakota legislature’s website, this change in the MBA is likely to take effect on August 1, 2025. That gives you some time to think about whether North Dakota is still a viable market for your financial products.