

January 22, 2019

**Via Email and U.S. Mail**

Department of Business Oversight  
Legal Division  
Attn: Mark Dyer, Regulations Counsel  
1515 K Street  
Suite 200  
Sacramento, CA 95814-4052

Re: Proposed Rulemaking: Commercial Financing Disclosures (PRO 01-18)

Dear Mr. Dyer:

The comments set forth below are provided in connection with the *Invitation for Comments on Proposed Rulemaking Commercial Financing Disclosures (PRO 01-18)* (the “Comment Request”) published on December 4, 2018, by the California Department of Business Oversight (“DBO”). Specifically, this letter is submitted on behalf of a firm client that is engaged in the purchase of “chattel paper”<sup>1</sup> originated by credit installment sellers or “leases” originated by product lessors (“Originating Creditors”) that provide credit programs to small businesses and professional individuals to facilitate the acquisition of products and services in connection with their business or trade (much like the photographer who buys commercial-grade camera equipment or the carpenter who buys commercial-grade building materials, in each case, to further their trade and not for personal, family or household purposes). To the extent that the professional individual operates as a sole proprietorship or legal business entity, the client also facilitates those same products and programs (collectively with credit to individuals in connection with business or trade, “Trade Credit”).

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<sup>1</sup> The term “chattel paper” is defined in Article 9 of the California Uniform Commercial Code as “a record or records that evidence both a monetary obligation and a security interest in specific goods, a security interest in specific goods and software used in the goods, a security interest in specific goods and license of software used in the goods, a lease of specific goods, or a lease of specific goods and license of software used in the goods.” In this paragraph, “monetary obligation” means a monetary obligation secured by the goods or owed under a lease of the goods and includes a monetary obligation with respect to software used in the goods. The term does not include (i) charters or other contracts involving the use or hire of a vessel or (ii) records that evidence a right to payment arising out of the use of a credit or charge card or information contained on or for use with the card. If a transaction is evidenced by records that include an instrument or series of instruments, the group of records taken together constitutes chattel paper. CA U.C.C. Law § 9102.

Our client appreciates this opportunity to comment on the first regulatory exercise by the DBO in connection with SB 1235 (Commercial Financing Disclosures, Chapter 1011, Statutes of 2018) (“SB 1235”). Moreover, we welcome this opportunity to provide comments as our client believes in the policy benefits that derive from transparency in the commercial credit market, allowing such borrowers to fully understand the cost and terms of proposed credit offers. It is against this backdrop that we provide the following comments to the DBO as it crafts regulations implementing SB 1235 (the “Final Rules”).

As published, the Comment Request contains numerous areas for which the DBO seeks input. While we acknowledge that the breadth of issues raised in the Comment Request that are worthy of comment is significant, we are providing comments only with respect to a crucial distinction that must be made in the Final Rules. Specifically, the DBO must ensure that entities that provide commercial financing to Originating Creditors in connection with their sale of chattel paper or leases are not included within the scope of SB 1235. This could be accomplished either by including a specific exemption to the definition of “commercial financing” that sets forth this exclusion or by modifying both the “factoring” and “asset based financing” definitions to set forth such an exclusion.

From a policy perspective, the specific exclusion of financing companies that purchase obligations from Originating Creditors from the scope of the Final Rules is critically necessary to ensure the proper and expedient functioning of this important segment of the commercial credit market (i.e., smaller dollar commercial transactions).<sup>2</sup> Originating Creditors enter into agreements with financing companies to ensure that there is a viable, liquid market for the commercial paper they originate,<sup>3</sup> allowing such originators to provide credit products to a significantly broader segment of the commercial credit market than would otherwise occur were such originators required to retain such credit agreements. These secondary market financing agreements include specific contract terms that set forth the volume, underwriting characteristics, and terms by which such financing companies will purchase Trade Credit obligations. These contracts are not related to the extension of credit *per se*; rather, they are intended to provide certainty to Originating Creditors with respect to the secondary market, allowing such creditors to have confidence in their ability to contractually assign such obligations to a known subsequent holder. Further, for the secondary paper market, requiring each second or subsequent acquirer of

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<sup>2</sup> A majority of the Trade Credit obligations secondarily financed by our client are below \$10,000; however, some can be as high as \$150,000.

<sup>3</sup> Note that, although agreements by financing companies to buy Trade Credit obligations bear a slight resemblance to factoring arrangements in that both contemplate the sale of receivables, the purchase of Trade Credit obligations from Originating Creditors pursuant to preexisting contractual arrangements are markedly different from factoring arrangements. First, these agreements are nearly always entered into before Originating Creditors have originated any credit agreements with their commercial credit customers; in contrast, in factoring arrangements, commercial creditors with cash flow challenges are selling the financial rights of their invoices for an immediate payment at a specified advance rate. Another difference is that factoring agreements typically involve no credit recourse against the seller of the obligation while financing contracts related to the purchase of Trade Credit obligations typically contain a recourse provision against the Originating Creditor. Finally, factoring typically involves the sale of short-term cash receivables while the sale of Trade Credit obligations typically involve multi-month, if not multi-year, contractual credit obligations.

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such leases or chattel paper to provide these disclosures to each immediately prior originator acquirer would create significant administrative burdens and information technology development requirements that are not contemplated in the systems that support the secondary paper markets. As such, because (i) these secondary purchase transactions from Originating Creditors are not providing the type of commercial credit contemplated by SB 1235, and (ii) the imposition of the requirements of SB 1235 on such transactions would have a negative impact on this segment of the commercial credit market by unnecessarily raising costs related to such transactions, these secondary market transactions related to the purchase of chattel paper must be specifically excluded from the scope of the Final Rules.

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We appreciate the opportunity to provide these comments. If you have any questions upon your review of the information contained in this comment letter, please do not hesitate to contact me at the number listed above.

Sincerely,



Christina J. Grigorian