



**Comments Regarding Modifications to Proposed Regulations
Under Division 9.5 of the California Financial Code
Commercial Financing Disclosures (PRO 01-18)**

The Commercial Finance Coalition (“CFC”) is comprised of responsible finance companies that provide needed capital to small businesses through innovative methods. CFC members offer accounts receivable purchase financing to small businesses (also known as merchant cash advance or “MCA”), and some members also engage in lending in the state of California through a California Financing Law license. Our members also include select vendors that provide technology services to the small business finance industry. This letter responds to the Department of Financial Protection and Innovation’s “Notice of Modifications to Proposed Regulations Under Division 9.5 of the California Financial Code” dated April 7, 2021.

We respectfully submit the following 10 comments:

1. Effective Date of Regulations

In the DFPI’s Initial Statement of Reasons released on September 2020 (<https://dfpi.ca.gov/wp-content/uploads/sites/337/2020/09/Initial-Statement-of-Reasons-SB-1235-9.2.pdf>), the DFPI stated that it would delay the effective date as follows:

Effective Date of the Regulations

The Department anticipates that the proposed regulations will go into effect, if adopted on or before January 1, 2021, on July 1, 2021. Since the proposed regulations will require affected businesses to implement new practices and procedures, July 1, 2021 represents a 6-month delay from the anticipated date of adoption in order to come into compliance. If, however, the proposed regulations are adopted after January 1, 2021, the effective date will adjust accordingly to maintain a 6-month delay in effectiveness. effectiveness of the regulations for at least 6 months.

However, in the most recent Notice of Modifications to Proposed Regulations, the DFPI made the following statement:

Please note that the proposed modifications are not yet effective and will not be effective until approved by the Office of Administrative Law and filed with the Secretary of State in accordance with Government Code section 11349.3.

If the proposed regulations go into effect accordance with Government Code section 11349.3, the effective date could be fewer than 6 months from adoption. We respectfully request that the DFPI honor the initial statement that effectiveness would be delayed at least 6 months.

2. Timing of Providing the Disclosure

Section § 2057(a)(4)(B) adds the following to the definition of “At the time of extending a specific commercial financing offer”:

- A. Any time a specific periodic payment or irregular payment amount, rate or price, in connection with a commercial financing, is quoted in writing to a recipient, based upon information from, or about, the recipient; and
- B. Within one business day of any time a specific periodic payment or irregular payment amount, rate or price, in connection with a commercial financing, is verbally quoted to a recipient, based upon information from, or about, the recipient, and before the commercial financing transaction is consummated;

It is unclear how a provider of commercial financing can reasonably comply with the requirement in (B) if any of the payment amount, rate or price terms are “verbally quoted” by a broker or other third party. In addition, a provider of commercial financing would be unable to defend itself against a claim that the provider failed to provide the disclosure within one business day of such “verbally quoted” information if there is no written record. Subsection (B) creates exposure for providers that they cannot reasonably defend against except by refuting that terms were verbally quoted to the recipient, with no means to provide additional support for the provider’s claim.

This requirement also is in conflict with California SB 1235’s requirement to provide the disclosures “to a recipient at the time of extending a specific commercial financing offer to that recipient.” (California SB 1235 Section 22802(a)). A verbal quote of terms is not an offer that a recipient can orally accept to bind the provider and should not, then, be treated as an offer to the recipient.

We further request that the DFPI clarify that by “specific” payment amounts, rate or price, a quote of a range of possible terms is not “specific” and would not, as a result, trigger the disclosure requirement.

3. Reasonably Anticipated True-Up

Section 2065(a)(6)(iii) requires disclosure at origination of the date and amount of any “reasonably anticipated true-ups.” The definition of the term “reasonably anticipated true-up” in Section 2057(a)(27) has been revised as follows:

Reasonably anticipated true-up” means any true-up that the financing provider has a reasonable basis to expect will be made during the term of the contract, ~~taking into account~~ accounting for past performance of similar contracts (both those made to the recipient and other similar recipients) and the policies and procedures of the financier.

Unless the recipient business communicates to the financing provider that its business is seasonal, a financing provider has no way to reasonably anticipate a true up, even “accounting for past performance of similar contracts.”

As a result, the requirement in Section 2065(a)(6)(iii) for a sales-based financing provider to disclose the date and amount of any reasonably anticipated true-ups will be difficult, if not impossible to comply with.

We respectfully ask the DFPI to remove the definition of “reasonably anticipated true-up” and the requirement to disclose the date and amount of any reasonably anticipated true-ups.

4. The Language Related to “If the Amount Financed is Less Than the Funds Available to the Recipient” is Unclear

Section § 2065 provides as follows:

Sales-Based Financing Disclosure Formatting

- a) Disclosures for all sales-based financing provided in accordance with section 22802 of the Code, except for asset-based lending that meets the definition of sales-based financing, shall comply with the following requirements:
 - 1) The provider shall present the required disclosures in a table consisting of ~~eight~~ **nine** rows and three columns.
 - 2) The first row of the table shall include only the following information:
 - a. In the first column, the following language: “Funding ~~You Will Receive~~ **Provided.**”
 - b. In the second column, the ~~amount of funds that will be provided to the recipient, excluding any deductions such as origination charges and amounts used to pay off other financings~~ **financed.**
 - c. In the third column, ~~a description of how the amount in the second column was calculated, including order listed and in one paragraph:~~
 - (i) ~~“This is how much funding [name of financier] will provide.”~~
 - (ii) **If the amount financed is less than the funds available to the recipient and the amount and description of any deductions** ~~financed does not include funds paid to brokers: “Due to deductions or payments to others, the total funds that will be provided to you directly is [recipient funds]. For example: “This is your advance more information on what amounts will be deducted, please review the attached document “Funding You Will Receive.””~~
 - (iii) **If the amount of [advance** ~~financed is less than the funds available to the recipient, and the amount]~~ **minus the [amount and description of fees deducted] financed includes funds paid to brokers: “We expect the total funds that will be deducted.”** ~~provided to you directly is [recipient funds] due to deductions or payments to other parties. For example, we will deduct [funds paid to brokers] to pay [“a broker”/ “brokers”]. For more information on what amounts will be deducted, please review the attached document “Funding You Will Receive.”~~

We are unfamiliar with situations in which the amount financed would be less than the funds available to the recipient. In other places in the proposed regulation, the inverse is covered (when the funds available to the recipient are less than the amount financed), such as the “Funding You Will Receive” disclosure in

Section 3027 that discloses the amount financed labeled as “Funding Provided” and then subtracts deductions to disclose the recipient funds.

We respectfully request that the DFPI provide additional clarity on what it means by disclosures required “If the amount financed is less than the funds available to the recipient.”

5. The “Purchased Amount” of Receipts is Not Based Upon Fees Charged by the Financing Provider

Section § 2065(a)(3)(D) provides for the following disclosure:

If no part of the finance charge is based upon an interest rate, the following language in addition to the language required by subdivision (3)(C) of this section: “APR it is not an interest rate. The ~~amount cost of the finance charge you will pay this financing~~ is not based upon ~~an~~ fees charged by [financer] rather than interest ~~rate that accrues over time.~~”

This disclosure conflates the difference between the Purchase Price paid to the recipient and the Purchased Amount with a “fee.” This is misleading and does not accurately describe the transaction.

6. The Disclosure of the “Maximum Non-Interest Finance Charge” Incorrectly Implies a Prepayment Penalty is Required

Section § 2065(a)(10) requires the following disclosure:

In the seventh row, the second and third columns shall be combined and shall include only:

- A. If, at any time during the term of the transaction, prepayment of the outstanding balance due will require the recipient to pay finance charges other than interest accrued since the recipient’s last payment, the following statement, “If you pay off the financing faster than required, you ~~will be required to still must~~ pay all or a portion of the finance charge, up to \$[maximum non-interest finance charge] based upon our estimates.”
- B. In all other cases, the following statement: “If you pay off the financing faster than required, you will not be required to pay any portion of the finance charge other than unpaid interest ~~owed since your last payment~~ accrued.”

Requiring the disclosure of a “finance charge” up to the “maximum non-interest finance charge” will likely confuse business owners into thinking that there is an additional amount charged for paying faster than required.

7. A Sales-Based Financing Transaction is Not a “Loan”

Section § 2091(b)(2) requires the following that applies only to sales-based financing:

A provider shall fix the number of months considered to determine the recipient’s average monthly historical sales, ~~or income income, or receipts for all transactions, or by~~ recipient industry or loan size (or both), provided that the period of historical data used by the provider shall not be less than four (4) months or more than twelve (12) months.

We respectfully request that the word “loan” be changed to “transaction.”

8. The Problem With Transactions That Require Payments Only on Weekdays

In Section § 3001 “Calculation of Annual Percentage Rate”, the following provision has been deleted from the section entitled “Calculation of Annual Percentage Rate”:

(c) When calculating the annual percentage rate, a provider may assume that it can collect payments on every calendar day, regardless of bank holidays, weekends, or other days that would otherwise delay or accelerate the provider’s collection of a payment.

An APR calculation for weekly and daily payments, if done accurately to account for weekends and holidays, can vary depending if the funding is done on a Monday or a Friday of the same week – even though it is the exact same product offer. Our research also indicates the online Annual Percentage Rate program (available at <https://www.ffiec.gov/calculators.htm>), does not calculate accurately for those products that anticipate payments only on weekdays.

Because there is a no publicly available calculator that can do this calculation, this disclosure requirement will exponentially increase costs of compliance. In addition, the inability to make an assumption that simplifies the calculation will increase litigation risk for providers of sales-based financing. As a result, this requirement will have an anticompetitive effect. Sales-based financing providers will likely raise the cost of their products or refrain from offering needed access to capital to California businesses.

We note that the APR calculations under TILA allow a provider to disregard the effects of certain factors in order to simplify the APR calculation, apparently in recognition of the complications and expense that would arise were creditors not permitted to do so. In particular, Regulation Z allows creditors to disregard that payments must be collected in whole cents, that dates of scheduled payments and advances may be changed because the scheduled date is not a business day, that months have different numbers of days, and the occurrence of a leap year. 12 CFR 1026.17(c)(3). Further, creditors are also permitted to disregard any irregularity in the first payment period that falls within certain prescribed limits. 12 CFR 1026.17(c)(4). The ability to disregard that dates of scheduled payments and advances may be changed because the scheduled date is not a business day, in particular, recognizes the complexity (and increased cost) that would result were the calculation to have to account for these days, as the DFPI’s proposal requires.

We respectfully request that the DFPI allow (but not require) providers to assume that it can collect payments on every calendar day. We also respectfully request that the DFPI either choose an easier-to-calculate method of disclosing an annual rate such as the Annualized Cost of Capital or create a safe harbor for good-faith attempts to calculate the Estimated APR for the first year of implementation.

9. Litigation and Recharacterization Risk

The newly added Section § 3024(b) provides as follows:

a) The rules of this Chapter are not intended to:

(1) Clarify or interpret existing California law with respect to the definitions of loan, sale, and lease, as those terms may apply to the commercial financing transactions regulated by this Chapter.

(2) Affect the Department of ~~Business Oversight's~~ Financial Protection and Innovation's authority to regulate any person or transaction under other laws under its jurisdiction, except to the extent permitted by section 22805 of the Code.

(b) A provider's mere use of any of the following words as required by this Chapter shall not constitute evidence that a financier's contract with a recipient is or is not a loan under California law: term or estimated term, interest, interest rate, payment or estimated payment, Annual Percentage Rate (APR) or Estimated Annual Percentage Rate, prepayment or pay off. This subdivision shall not preclude a trier of fact from considering a provider's statements in the disclosures required by this Chapter when assessing whether a transaction, based upon the totality of the circumstances, is a loan under California law.

It appears that this language was added to address the significant litigation risk that providers of commercial financing face in the wake of the disclosure requirements. However, expressly allowing a judge or jury to view the disclosures as evidence that a transaction was a loan under California law creates more harm.

We respectfully ask that the DFPI:

- Add "or create a presumption" after "constitute evidence" in the first sentence of (b); and
- Delete the second sentence of (b) so that this provision would read as follows:

(b) A provider's mere use of any of the following words as required by this Chapter shall not constitute evidence or create a presumption that a financier's contract with a recipient is or is not a loan under California law: term or estimated term, interest, interest rate, payment or estimated payment, Annual Percentage Rate (APR) or Estimated Annual Percentage Rate, prepayment or pay off.

10. The "Estimated Monthly Cost" Disclosure Will Create Customer Confusion and Provider Liability

Section 2065(a)(12) requires a sales-based financing provider to disclose the "Estimated Monthly Cost" if the contract provides for periodic payments that are not monthly. As the DFPI has refined the definition of "Estimated APR" it has become apparent that the Estimated Monthly Cost disclosure is based on a calculation that is wholly different from the "Estimated APR" disclosure. As a result, the disclosures will feature a monthly representation of the cost of capital that is unrelated to the annual representation of the cost of capital. This will confuse customers and create liability for providers of financing related to claims that the disclosures are deceptive. We also note that SB 1235 did not include an "Estimated Monthly Cost" disclosure in its mandate that the DFPI adopt regulations. We respectfully request that the DFPI remove the "Estimated Monthly Cost" disclosure from the regulations.