ELECTRONIC TRANSACTIONS ASSOCIATION
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April 26, 2021

Commissioner of Financial Protection and Innovation
Attn: Sandra Sandoval, Regulations Coordinator
300 South Spring Street, 15th Floor
Los Angeles, CA 90013

Via Electronic Mail to: regulations@dfpi.ca.gov
With a copy to: Charles Carriere, [redacted]@dfpi.ca.gov
Jesse Mattson, [redacted]@dfpi.ca.gov

Re: Comments on the Modifications to the Proposed Regulations on Commercial Financial Disclosures (PRO 01-18)

Dear Ms. Sandoval,

On behalf of the Electronic Transactions Association ("ETA"), the leading trade association for the payments industry, I appreciate the opportunity to share our thoughts with the California Department of Financial Protection and Innovation ("DFPI") regarding the revised text for its proposed Commercial Financing Disclosure Regulations (PRO 01/18 – SB 1235) (the "Proposed Regulations"). ETA supports transparency in small business financing disclosures, including providing borrowers with the best information to compare costs across products and make informed decisions. ETA supports a competitive marketplace for small business financing with fair, transparent, and readily understandable financing options.

Good public policy on this issue dictates that disclosures allow for small businesses to be able to accurately compare total costs across products. In that vein, please find our recommendations outlined below that we believe will ensure the regulations are implemented smoothly and that will provide more clarity to both providers and recipients of small business financing.

IMPLEMENTATION DATE

While ETA appreciates the work of DFPI to promulgate sound rules, commercial creditors have not yet been able to implement changes given that the proposed rules continue to be modified. Given that significant changes are required on the backend for implementation, DFPI should provide at least 6 months to implement required changes after the final regulations are released. This time period, which comports with previous comments by the Department,[1] would ensure that companies would have enough time to make internal changes and work with vendors and other third parties to ensure a smooth implementation.

VARIANCE OR EXEMPTIVE RELIEF

The Proposed Regulations take on the task of applying concepts developed for consumer financing products to a novel context. From time to time, innovative products may appear that have features not clearly contemplated by the disclosure categories and requirements set forth in Sections 2061 – 2068. To ensure that it can remain nimble and react to market developments, DFPI should include in the final regulations a mechanism by which financers can apply to the DFPI to vary the prescribed disclosures or seek exemptive relief.

[1] https://dfpi.ca.gov/wp-content/uploads/sites/337/2020/09/Initial-Statement-of-Reasons-SB-1235-9.2.pdf

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SECTION 2061 – DISCLOSURE OF NON-INTEREST/NON- FEE PRODUCTS

Transactions that do not have interest or fees should be excluded from the disclosures in Section 2061 as the disclosures for these transactions could be misleading and confuse recipients of the funds. For example, in instances where there is no finance charge for prepaying, the Proposed Regulations would require prepayment disclosure language that states: "If you pay off the financing early, you will not need to pay any portion of the finance charge other than unpaid interest accrued." The reference to a finance charge and interest may cause confusion about whether or not fees are charged for programs that do not actually assess any fees or interest.

TIMING OF DISCLOSURES

Unlike the federal Truth in Lending Act ("TILA"), the proposed regulations would require all disclosures be made whenever a payment amount, rate, or price is quoted based on information provided by a proposed borrower/recipient of financing. For consumer financing, TILA only requires that disclosures be made "before the transaction is consummated", which gives flexibility to the creditor as to when and where to disclose as long as this requirement is met. This flexibility is important as it is common for commercial finance entities to provide preliminary quotes about potential financing terms (estimates) based on partial information provided by the borrower and/or prior to full underwriting, including any Bank Secrecy Act ("BSA")/Anti-Money Laundering ("AML") screening. Requiring full disclosure at this stage seems unduly burdensome and disruptive to the user experience, especially if the borrower is just trying to determine commercial finance options.

SECTION 3027 – ADDITIONAL DISCLOSURE REQUIREMENTS

ETA supports the addition of a broker fee disclosure to the proposed regulation as consistent with the purpose of the regulation, which is to empower small businesses to compare all costs associated with a commercial financing offer. However, ETA urges that the definition of the broker fee, "Funds paid to brokers," be expanded to include all amounts paid to a broker in connection with a specific offer of commercial financing where such amount varies based on the specific offer of financing, not just amounts that are characterized as a deduction from the amount financed. In addition, to prevent confusion, the information regarding the funds paid to brokers should be required to be disclosed should be included in the main disclosure to ensure the borrower receives this information up front as part of the overall disclosure, rather than in a separate calculation, and urges corresponding changes to the formatting and content requirements to include the "Funds Paid to Brokers" by either the provider or the broker.

SECTION 2091 – SALES-BASED FINANCING – HISTORICAL METHOD

The calculation procedure for estimating monthly sales, income, or receipts allows providers to exclude from calculation months where decreases in monthly sales, income, or receipts are unlikely to recur. Section 2091(b)(4) should be modified to permit providers to also exclude from calculation months where *increases* in monthly sales, income, or receipts are unlikely to recur. As the Covid-19 pandemic has demonstrated, certain kinds of natural disasters or uncommon business interruptions may cause sudden, unexpected declines in business activity in some industries, and sudden, unexpected increases in business activity for other industries. Providers should be able to maintain the flexibility to determine that these kinds of slingshot effects are unlikely to reoccur in both directions.

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SECTION 2062 – COMMERCIAL OPEN-END CREDIT PLAN DISCLOSURE FORMATTING

The Proposed Regulations currently create significant challenges for clear and meaningful disclosure of the cost of credit for commercial open-end credit plans that charge transaction-based fees. These challenges are created by the Proposed Regulation's selective cross-referencing to Regulation Z and could be mitigated by more fully incorporating by reference the provisions of Regulation Z that apply to open-end credit.

Under both the Proposed Regulations and Regulation Z, transaction-based fees are finance charges. ETA believes that this is the correct approach, and all fees, including transaction-based fees and one-time charges, should be clearly disclosed to recipients. Unlike Regulation Z, however, the Proposed Regulations require that *all* finance charges be included in the annual percentage rate ("APR") calculation, rather than only interest rates that apply to periodic balances.[2] Under the Proposed Regulations, providers would be required to assume that a recipient borrows the approved credit limit at origination within a single transaction. Including all finance charges in the resulting APR calculation, including transaction-based fees as well as one-time upfront fees (e.g., card creation fees), has the potential to result in confusing APR disclosures by mixing rates and fees, particularly for commercial open-end credit plan that charge no interest.

Regulation Z, on the other hand, treats APR disclosure and transaction-based fee disclosure for open-end credit products separately. At account opening, providers must disclose the APR, defined as "*[e]ach periodic rate* that may be used to compute the finance charge on an outstanding balance… *expressed as an annual percentage rate*."[3] Also at account opening, but separate from the APR disclosure, providers must disclose "[a]ny transaction charge imposed by the creditor for use of the open-end plan for purchases."[4] A model form illustrating what Regulation Z would require was introduced into Appendix G to Regulation Z by the Board of Governors of the Federal Reserve System (the "Federal Reserve") in a 2008 rulemaking amending Regulation Z.[5] This model form clearly delineates between disclosure of interested-related charges, which includes APR disclosure, and disclosure other fees, including transaction-based fees, one-time fees, or fees that depend on borrower behavior.

Prior to that 2008 rulemaking, Regulation Z required providers to disclose an "effective APR" in periodic statements after account opening. This effective APR reflected both the cost of interest and certain other finance charges imposed during the statement period. The Federal Reserve conducted extensive consumer testing of this concept and ultimately determined in that 2008 rulemaking that this method for APR calculation and disclosure generated deep consumer confusion. As a result, it eliminated the effective APR requirement from the final rulemaking. The Federal Reserve wrote that although "a majority of participants evidence some understanding of the effective APR, the overall results of the testing show that most consumers do not correctly understand the effective APR…. [I]n all rounds of the testing, a majority of participants did not offer a correct explanation of the effective APR. In quantitative testing conducted for the [Federal Reserve] in the fall of 2008, only 7% of consumers answered a question correctly that was designed to test their understanding of the effective APR. In addition, including the effective APR on the statement had an adverse effect on some consumers' ability to identify the interest rate applicable to the account."[6]

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[2] See Proposed Regulations, Section 3001(b) and 3010.
[3] 12 C.F.R. Part 1026(b)(2)(i).
[4] 12 C.F.R. Part 1026(b)(2)(iv).
[5] See Federal Reserve, Truth in Lending, 74 Fed. Reg. 5244, at 5432. See also 12 C.F.R. part 1026, Appendix G, G-17(B).
[6] 74 Fed. Reg., at 5252. See also 74 Fed. Reg. 5316 – 5319 for more discussion.

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A *prospective* effective APR for a commercial open-end credit plan that mixes rates and fees is likely be even more confusing than an *ex post* effective APR. A novel prospective effective APR requirement that departs from well-researched and well-established practice under Regulation Z should be carefully considered to determine whether it will enhance borrower understanding. ETA urges the DFPI to hew more closely to Regulation Z's approach and more clearly delineate finance charges that should be clearly disclosed to borrowers and finance charges that should be included in APR calculations.

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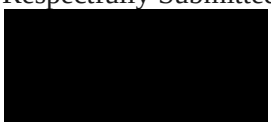
We appreciate you taking the time to consider these important issues. If you have any questions or wish to discuss any aspect of our comments, please contact me or ETA Senior Vice President, Scott Talbott at Stalbott@electran.org.

Respectfully Submitted,



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ETA is the leading trade association for the payments industry, representing over 500 companies that offer electronic transaction processing products and services. ETA's members include banks, mobile payment service providers, mobile wallet providers, money transmitters and non-bank FinTech companies that provide access to credit, primarily to small businesses, either directly or in partnership with other lenders.

ETA member companies are creating innovative offerings in financial services, revolutionizing the way commerce is conducted with safe, convenient, and rewarding payment solutions and lending alternatives – facilitating over $22 trillion in payments in 2019 worldwide.