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April 26, 2021

Via Email and Hand Delivery

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

Re: Notice of Modifications to Proposed Regulations Under Division 9.5 of the California Financial Code Pro 01/18 - Commercial Financing Disclosure Regulations (SB 1235)

Dear Ms. Sandoval:

The comments set forth below are provided in connection with the *Notice of Modifications to Proposed Regulations Under Division 9.5 of the California Financial Code (PRO 01-18)* published on April 7, 2021 (the "Comment Request"), by the California Department of Financial Protection and Innovation ("DFPI") as it relates to certain commercial financing disclosures to be provided by providers of commercial credit (the "Proposed Disclosures"). Based upon our review of the revisions provided in connection with the Comment Request as well as the review of a third party consultant who has been retained to assist certain clients of our firm in quantitative compliance with the calculations required by SB 1235 and the Proposed Disclosures, we raise the following issues for your consideration:

**Section 2057(a)(30)**

We recommend deleting the definition of "Amount financed" as set forth in the Comment Request and replacing it with the definition set forth in 12 CFR § 1026.18(b) which provides as follows:

*Amount financed. The amount financed, using that term, and a brief description such as the amount of credit provided to you or on your behalf. The amount financed is calculated by: (1) Determining the principal loan amount or the cash price (subtracting any down payment); (2)*

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*Adding any other amounts that are financed by the creditor and are not part of the finance charge; and (3) Subtracting any prepaid finance charge.*

This revision is necessary because, as set forth in the Comment Request, the proposed definition of the term fails to inform the commercial credit provider as to the treatment of prepaid finance charges (as noted above, pursuant to Regulation Z, the “amount financed” is determined by taking the principal loan amount, adding amounts that are financed but not part of the finance charge, and subtracting any prepaid finance charges). Such an adoption would both simplify the definition and also allow providers of commercial credit a method by which to determine the treatment of prepaid finance charges (such as a loan origination fee) for purposes of this term and its use in calculating the required disclosures. Moreover, such an adoption is necessary because, without an understanding of the treatment of prepaid finance charges or amounts that are financed but not finance charges, the calculation of the Annual Percentage Rate (“APR”) cannot be calculated in compliance with Section 3001(a) which specifically *requires* that the APR be “determined in accordance with either the United States Rule method or the actuarial method, both as set forth in Appendix J, 12 CFR Part 1026 (effective December 30, 2011), and which is incorporated herein by reference.” Importantly, both the United States Rule method and the actuarial method rely upon the “amount financed” as such term is defined in Regulation Z.<sup>1</sup> In summary, the adoption of the definition of “Amount financed” in the applicable federal regulation is necessary so that programmers calculating the APR understand the treatment of all charges applicable to the proposed financing.

### **Section 2057(a)(31)**

We recommend revising the definition of “Recipient Funds” as set forth in the Comment Request and replacing it with a definition that does not incorporate the “amount financed.” Specifically, we suggest the following which revises the first sentence of the proposed definition but retains the second:

*“Recipient funds” means the funds given to the commercial borrower in the form of cash or a check. Recipient funds excludes, without limitation, any funds used to pay off other financings, funds paid to brokers and funds paid to other third parties.*

The definition of “recipient funds” should not reference the term “amount financed” because, assuming the DFPI accepts the change to the definition of “amount financed” suggested above, the reference to “amount financed” in this definition would not provide the borrower with an accurate dollar amount of the total funds actually made available after consummation of the proposed financing transaction. Moreover, using the first sentence proposed above tracks the Official Staff Interpretation for 12 CFR § 1026.18.<sup>2</sup>

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<sup>1</sup> See Appendix J to Part 1026, *Annual Percentage Rate Computations for Closed-End Credit Transactions*, Sections (a)(2) (actuarial method) and (a)(3) (United States Rule).

<sup>2</sup> Official Staff Interpretation for 12 CFR 1026.18(c)(1)(i) provides in relevant part as follows:  
*“Amounts paid to consumer. This encompasses funds given to the consumer in the form of*

### **Section 2060(a)**

We recommend reinserting the language that was struck in former Section 2060(3) when calculations required by the Proposed Disclosures are based on monthly payments and adding a specific phrase confirming that such subsection applies to disclosures that are calculated on a monthly basis. Specifically, we believe that the language should read as follows:

*For the purposes of these disclosures for transactions repaid on a monthly basis, a provider may assume that there are 30 days in every month and 360 days in a year. For example, a term of 400 days would be disclosed as "1 year, 1.33 months."*

This change is necessary to provide certainty to programmers of these monthly calculations and will eliminate confusion about the actual number of days between payments with monthly loans, which is one component of a commercial financier's determination of the Annual Percentage Rate.

### **Section 3026(a)(2)**

We propose deleting subsection (a)(2) of this provision. Based on discussions with the third party consultant referenced above, the language in (a)(2) is unduly burdensome and complex and does not align with Regulation Z. Instead, we propose a new (a)(2) that tracks 12 CFR 1026.22(a)(3) which provides as follows:

*In an irregular transaction, the annual percentage rate shall be considered accurate if it is not more than  $\frac{1}{4}$  of 1 percentage point above or below the annual percentage rate determined in accordance with paragraph (a)(1) of this section. For purposes of this paragraph (a)(3), an irregular transaction is one that includes one or more of the following features: multiple advances, irregular payment periods, or irregular payment amounts (other than an irregular first period or an irregular first or final payment).*

Given that the DFPI has already included Regulation Z's general tolerance rule as set forth at 12 CFR § 1026.22(a)(2), it would be consistent for Section 3026(a)(2) to track Regulation Z's tolerance formula for irregular transactions as set forth at 12 CFR § 1026.22(a)(3). This uniformity in determining permissible risk tolerances is particularly important given that APRWIN and the Federal Financial Institutions Examination Council's tool for determining annual percentage rates and related tolerances use both tolerances set forth in Regulation Z and federal and state regulators rely upon such automated tools in their examinations related to annual percentage rate calculations. As such, adopting the additional toleration provision from Regulation Z will ensure uniform regulatory treatment of tolerance allowances.

### **Section 3027**

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cash or a check, including joint proceeds checks, as well as funds placed in an asset account."

As proposed, Section 3027 does not align with the definitions and requirements in Regulation Z. We propose that this provision be deleted and replaced with a requirement to provide an Itemization of Amount Financed pursuant to 12 CFR § 1026.18(c)<sup>3</sup> in instances where the “amount financed” (as defined pursuant to our proposed definition above) is greater or less than the “recipient funds” (as defined pursuant to our proposed definition above). Specifically, we suggest that Section 3027 read as follows:

*(a) When a provider provides a disclosure (either directly to the recipient or to a broker) under Sections 2061 through 2068, and the amount financed is greater or less than the recipient funds, the provider shall also provide a disclosure entitled “Itemization of Amount Financed” which is prepared in accordance with 12 CFR § 1026.18(c). The disclosure shall be substantially similar in form to the example disclosure provided in subdivision (b) below.*

*(b)(1) Example Disclosure for non-refinanced transactions (asterisked provisions are for provider’s use only and should not be disclosed to the borrower):*

ITEMIZATION OF AMOUNT FINANCED:	\$9,000.00
1. Amount Given Directly to You	\$8900.00*
2. Property Valuation Fee paid to [____]	\$100.00**
3. Brokerage Fee paid to [____]	\$1,000.00
4. Amount Provided to You or on Your Behalf (1+2+3)	\$10,000.00
5. Prepaid Finance Charges: Brokerage Fee	\$1,000.00
6. Amount Financed (4 minus 5)	\$9,000.00***

\* As determined by 12 CFR 1026.18(c)(1)(i) and as defined in “Recipient Funds”

\*\* This amount is excluded from the Finance Charge.

\*\*\* Used to calculate the APR in accordance with Section 3001.

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<sup>3</sup> The provision provides as follows: *Itemization of amount financed.* (1) Except as provided in paragraphs (c)(2) and (c)(3) of this section, a separate written itemization of the amount financed, including: (i) The amount of any proceeds distributed directly to the consumer. (ii) The amount credited to the consumer's account with the creditor. (iii) Any amounts paid to other persons by the creditor on the consumer's behalf. The creditor shall identify those persons. The following payees may be described using generic or other general terms and need not be further identified: public officials or government agencies, credit reporting agencies, appraisers, and insurance companies. (iv) The prepaid finance charge.

(b)(2) Example disclosure where borrower refinances an existing commercial obligation (asterisked provisions are for provider's use only and should not be disclosed to the borrower):

ITEMIZATION OF AMOUNT FINANCED:	\$11,000.00
1. Amount Given Directly to You	\$8900.00*
2. Property Valuation Fee paid to [____]	\$100.00**
3. Brokerage Fee paid to [____]	\$1,000.00
4. Amount Paid on your Account with Us (#XXXXXX)	\$2,000.00
5. Amount Provided to You or on Your Behalf (1+2+3+4)	\$12,000.00
6. Prepaid Finance Charges: Brokerage Fee	\$1,000.00
7. Amount Financed (5 minus 6)	\$11,000.00***

\* As determined by 12 CFR 1026.18(c)(1)(i) and as defined in "Recipient Funds"

\*\* This amount is excluded from the Finance Charge.

\*\*\* Used to calculate the APR in accordance with Section 3001.

### **Additional Provisions That Were Not Included in the Comment Request**

Finally, while we are aware that the DFPI is not seeking comments to text that was not modified as set forth in the Comment Request, we believe the following provisions in the Proposed Disclosures should also be revised:

(1) All references to any provision in the final regulations referencing Regulation Z should specifically reference that Supplement I to Part 1026, *Official Interpretations*, also apply to the use or reliance on such provision for purposes of compliance with the final rules. Inclusion of this language will allow providers of commercial credit and their programmers to rely upon the body of interpretive guidance that has grown over the last 50 years through federal regulatory interpretation of terms set forth in federal law.

(2) Section 3000 must be revised because it includes two different points in time as currently drafted: (a) the point in time when a provider extends a specific financing offer to a recipient, and (b) the time at which the financing is extended. While (a) and (b) may be contemporaneous, in many cases, they are not. Moreover, this definition does not work when one considers the requirements set forth in Section (b)(2) of Appendix J, 12 CFR Part 1026, which provides as follows:

*Term of the Transaction.* The term of the transaction begins on the date of its consummation, except that if the finance charge or any portion of it is earned beginning

Ms. Sandra Sandoval

April 26, 2021

Page 6

on a later date, the term begins on the later date. The term ends on the date the last payment is due, except that if an advance is scheduled after that date, the term ends on the later date. For computation purposes, the length of the term shall be equal to the time interval between any point in time on the beginning date to the same point in time on the ending date.

In light of this, we propose that Section 3000 be revised to read as follows:

*(a) Any provider who extends a specific offer of commercial financing to a recipient shall, at the time of extending the specific commercial financing offer, disclose to the recipient the annual percentage rate.*

The inclusion of *offer* ensures that providers can determine the APR in compliance with Appendix J to Regulation Z.

\* \* \*

We appreciate the opportunity to provide the information set forth above in connection with the Comment Request. 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. Moreover, if a conversation with our third-party consultant who is advising the firm's clients on the technical formulas needed to comply with the calculations in the Proposed Rule would be beneficial for the DFPI as it reviews newly submitted industry comments, we would eagerly facilitate such a discussion given that the issues identified in this comment letter relate almost exclusively to challenges raised by the current draft in creating the necessary calculations to comply with the Proposed Rule.

Sincerely,

A solid black rectangular redaction box covering the signature of Christina J. Grigorian.

Christina J. Grigorian