Submitted by Electronic mail to: regulations@dfpi.ca.gov, with a copy to: [redacted]@dfpi.ca.gov and [redacted]@dfpi.ca.com

April 26, 2021

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

Re: File No.: PRO 01-18 – Fifth Invitation for Comments on Proposed Rulemaking for Commercial Financing Disclosures ("Invitation")

Dear Commissioner Alvarez,

Small Business Financial Solutions, LLC dba RapidAdvance ("RapidAdvance") would like to thank the California Department of Financial Protection and Innovation ("DFPI") for reaching out for input on the above proposed regulations ("Regulations"). RapidAdvance previously provided four in-depth comments to the informal requests for comments detailing a broad range of issues. In our previous comment letters, we provided a great deal of information regarding annual percentage rates ("APR") and the issues created by new Division 9.5 of the Financial Code (the "Code"). We request that our initial letters be reviewed again as they contain extensive information that the proposed Regulations still do not address.

The proposed Regulations addressed many issues we raised regarding formatting issues and technical items. We appreciate the DFPI incorporating and addressing many of our suggestions and concerns. However, the proposed Regulations still fail to remedy a number of substantive issues that are necessary in order for the required disclosures to be clear, meaningful, and effective.

I. OUR COMPANY

RapidAdvance provides working capital to small businesses throughout the United States and operates as a licensed Finance Lender and Broker in California. RapidAdvance and its affiliates have been providing funding to small businesses for more than a decade and the majority of our customers have grown to become thriving businesses. Our financing products include merchant cash advances ("MCAs") and business loans. MCAs allow small retail businesses to sell their future card sales in exchange for immediate working capital (the transaction is a purchase and sale rather than a loan). The receivables we purchase are delivered to us whenever the merchant batches out its credit card terminal and forwards to us the percentage of funds that we purchased. We do not offer an MCA product in California that includes a true-up mechanism or a fixed payment amount (each payment truly varies based on the split rate). Our small business loan is similar to a traditional commercial loan with two primary differences. First, the borrower makes daily or weekly payments rather than monthly payments. Second, our loans charge a fixed fee rather than an interest rate. A fixed fee allows our customers to easily determine the actual dollar amount the loan will cost and the more frequent payment schedule ensures the business is not overwhelmed by large monthly payments for years. Our underwriting model allows us to fund businesses that traditional lenders turn away and permits us to offer financing solutions to businesses whose growth is constrained by their ability to access capital. Our customers that qualify for both the loan product and the MCA can choose the product that best fits their needs.

The customers that use our financing products include almost every type of small and medium sized business in California. A customer's annual revenue generally ranges from $250,000 to $4,000,000 and the average funding we provide is about $50,000. Approximately 90% of our customers are limited liability companies or corporations. The online small business finance industry now originates more than $15 billion annually and the overwhelming majority of small businesses that have obtained financing from industry participants prefer our products and process over traditional financing sources. The industry has proven to be a great option for small businesses during COVID. Given our products don't have an accruing rate and most businesses have been shut down or negatively impacted since March, many of our customers are not in default despite not making payments (MCAs don't require a payment if there is no revenue being generated due to COVID) or have extended their terms under our loan program for free as we don't charge an accruing rate. The current environment is a great example of why our products work better than traditional loan products and why our customers love us.

II. COMMENTS

A. Definitions

(i) "At the time of extending a specific commercial financing offer" (Section 2057(a)(4)) – Although the proposed Regulations implemented some of our comments regarding re-disclosure, they do not address the most significant issue we raised – the fact that applicants will be confused as they will receive numerous disclosures. The proposed Regulations require disclosures whenever a "specific amount, rate or price" is quoted to a recipient "based upon information from, or about, the recipient." The use of the word "about" creates material issues. All information a provider gives to a recipient is "about" that recipient in some fashion. So if a provider gave an example of how a transaction would work and used totally imaginary numbers that would still be "about" the recipient and arguably require disclosures. This would be the case even if the provider never obtained a bank statement from the recipient, never confirmed they own a business, and never quoted a rate or price. This is simply not workable and will lead to totally unreliable and incomplete disclosures. We suggest the "about" be deleted so that disclosures are given based on specific information "from the recipient."

Additionally, it is very common to quote amounts to applicants without including pricing. This is done to confirm the amount the business wants and to confirm the provider is interpreting the applicant's bank statements, debt service and cash flow properly. Because pricing has not been considered or presented at that point, it would be impossible to provide the required disclosures. We highly suggest the definition be amended to provide that a specific offer is made when a "specific amount, term, cost and periodic payment amount" is quoted to a recipient based on information provided from the recipient. These four terms are the terms every applicant needs to know in order to decide whether or not to obtain capital and are at the crux of comparing different financing offers. As written, this regulation violates the Clarity standard[1] of the California Administrative Procedure Act (APA).[2]

Moreover, requiring the disclosures to be provided so early in the process will lead to significant issues given the high number of quotes that are typically provided. Some recipients want to see what the quote would be for a six (6), ten (10) or twelve (12) month

[1] CA Government Code § 11349(c)
[2] CA Government Code, Chapter 3.5, Part 1, Division 3, Title2

terms, which, according to the proposed Regulations, would require disclosures for each term. If a recipient wanted to see those same three quotes for both a closed-end transaction and a sales-based financing transaction, a provider would be required to give the recipient six (6) disclosures. To make matters worse, the vast majority of commercial finance transactions are negotiated with multiple changes to the terms of the transaction. The proposed Regulations would require new disclosures each time a disclosed term changes (even when the changes work to the recipients favor). This will cause applicants to receive dozens of pages of different disclosures for each transaction. This will result in an overwhelming number of disclosure forms and, as a result, recipients will likely just ignore the disclosures all together. This scenario is amplified if the recipient is looking at financing options from multiple providers (a very common practice).

The disclosure timing issue is exactly why the Truth in Lending Act ("TILA") requires disclosures to be provided at or prior to consummation. *See* 12 C.F.R. §1026.17(a)(2). There is no requirement under TILA that disclosures be provided when a quote is issued or negotiations are ongoing. In fact, TILA expressly rejected this concept based on the complications it presents. Moreover, under contract law, there must be an actual offer for there to be an acceptance. Providing quotes based on limited information about the recipient does not constitute an offer that if the recipient accepted would constitute a contract.

The timing for the proposed disclosures is made even worse when you think about the technology advances industry participants are experiencing. For example, as part of our process, an account is created that displays the different terms and products available for that recipient. Once the recipient chooses which quote works best, the contract along with the terms are then sent to the recipient to be signed. The proposed Regulations require that all of the quotes be provided with the disclosures so we would have to program our system to generate all of the disclosures anytime a term changes, keep track of the disclosures, and send the disclosures via email, DocuSign, facsimile or by mail. We would then follow that up with a contract once they select the terms they want to proceed with.

Moreover, the majority of providers have some type of online recipient portal where either new or current recipients can apply for financing. Typically, the recipient will create an account and input information about the recipient. Based on the information received by the recipient, the provider is usually able to provide a maximum and minimum amount of financing that the recipient may qualify for. The recipient is then able to manipulate the financing tool (*e.g.* a financing slider that increases or decreases the financing while showing terms and fees) to show how much the financing may cost depending on how much financing the recipient obtains. Based on the definition for "extending a specific commercial financing offer" because the provider has obtained information about the recipient and has provided a specific amount and a term, the provider is then required to send a disclosure to the recipient. That means that anytime a recipient decides to change the amount by sliding the bar (which in turn changes the specific amount and term) the provider would be required to provide a disclosure. For example, let's say a recipient inputs information into the recipient portal and is shown that it may qualify for financing between $5,000.00 and $50,000.00. Theoretically, that recipient could adjust the slider in increments of one dollar ($5,001.00, $5,002.00, etc.) and the provider would be required to provide 45,000 disclosures. There is no reason to provide the recipient with such an absurd number of disclosures. Furthermore, many providers have a generic pricing tool on their website to allow for a recipient to plug in some basic information (estimated annual revenue, time in business, etc.) and it gives a potential for the amount of financing that might be available to the recipient. Based on the requirements of the proposed Regulations, each time the recipient uses that online tool a provider would have to give a disclosure. This is nonsensical because the recipient might be using this tool before officially submitting an application. However, the provider would technically be receiving information from the recipient and be required to provide disclosures. Given the numerous disclosures required to be given by the proposed Regulations, it is likely that providers will, as a result, limit recipients' ability to receive quotes in order to avoid having to provide an excessive number of disclosures. This outcome is contrary the original intent of the California Legislature to provide recipients more information about their commercial financing transactions.

While we do appreciate the revisions to the proposed Regulations addressing our concerns regarding re-disclosure after consummation and limiting it to an "increase to the finance charge" there should be additional language that exempts requiring re-disclosure in the event of a default. We suggest the proposed Regulation be amended to make it clear that such re-disclosure would not be required for any changes that occur as a result of the recipient's default. It is common for transactions in default to be provided extensions (usually with no new fees). This is not the manner in which amendments and workouts are generally handled under TILA. Under 12 C.F.R. § 1026(a)(1), there must be a refinancing for new disclosures to be required. A refinancing is defined to include amendments where the rate is increased from the previously agreed upon rate but a change in payment amount or term as a result of a default is not a refinancing requiring new disclosures. We suggest the proposed Regulations be amended to follow this same definition or it will create material confusion. The proposed Regulations do not address these scenarios at all. Because the proposed Regulations require re-disclosure when terms of the loan are unchanged, it violates the Necessity standard[3] of the APA. It is not reasonably necessary to effectuate the purpose of the statute, in violation of CA Government Code section 11342.2.

(ii) Initial Interest Rate (Section 2057 (a)(12)) – This definition does not take into account default rates. The proposed Regulations should make it clear that changes in the rate due to a default are not subject to this section (this is how it is handled in TILA).

(iii) Sales-based financing (Section 2057(a)(22)) – We provided comments on this definition previously; however in the new proposed Regulations, our concerns have not been addressed. The proposed Regulations attempt to differentiate between closed-end transactions and sales-based financing, but there is still overlap which will create uncertainty as to what disclosures a provider should deliver. This differentiation is important to get right and make sure there is no confusion as the disclosures for sales-based financing include estimated APR and estimate term but closed-end transactions do not. Confusion will arise in connection with products that have hybrid repayment features where payments are based on sales revenue but there is also a minimum payment component that creates a "term." Many participants in the industry treat these products as closed-end loans with unique payment features. Because there is an actual term for these transactions, they generally fit within California's definition of a loan. This should not be

[3] CA Government Code § 11349(a)

confused with sales-based financing products with true-up features. These are different as the true-up feature may shorten or lengthen the estimated term of repayment. For these transactions, there is no fixed term that can be calculated until all payments have been made. Therefore, the sales-based financing disclosures are appropriate. However, for loan products with unique payment features that include variable payments but require periodic minimum amounts and therefore have a fixed term, the proposed Regulations should make it clear that these products are closed-end transactions and not sales-based financing products. The definition of "closed-end transaction" appears to address this but in subpart (B) it refers to these transactions as a type of sales-based financing although they are not sales-based financing transactions as they are just unique loan products.

We suggest this issue be resolved by amending the definition of "closed-end transaction" and "sales-based financing" as follows:

1. Closed-end transaction means a transaction in which credit is extended only once over a specific term (including contracts that include an option in which the recipient may extend the term) or that the provider identifies as a loan, and is repaid:
    A. In regular predetermined payments of specified amount over a fixed period of time; or
    B. In a combination of variable payments and fixed minimum amounts so that the full amount is repaid during a fixed contractual term or where the contract requires all amounts be repaid by a specific date.
2. Sales-based financing means a commercial financing transaction that is not a closed-end transaction, that is paid by a recipient to the financer as a percentage of sales or revenue, in which the payment amount increases and decreases according to the volume of sales made or revenue received by the recipient and is not identified as a loan by the provider. Sales-based financing also includes commercial financing transactions that have a set payment amount that is based on a percentage of the recipient's sales or income but has a "true-up mechanism."

B. General Formatting and Contents[4]

The additions to the general formatting and contents are greatly appreciated as they address many concerns raised in the previous version of the proposed Regulations. We think the additions will make it easier for recipients to compare products. Although this section is immensely improved, there are a still a few items that need to be addressed in order to make sure the disclosures are as clear as possible. Below are additional requirements we believe would help make the disclosures more meaningful:

(i) Offer Summary (Section 2060(a)(1)) – Once again we thank the DFPI for taking our suggestion of allowing a provider to disclose what type of financing product is showing on the disclosure; however, the way this reads is confusing as the word "For" after "Offer Summary" seems out of place. We would suggest that the word "For" be deleted so that the sentence would read, ""Offer Summary" in bold font, followed by a one-to five-word description of the type of product offered" so that in practice, a header would read "Offer Summary – Business Loan and Security Agreement."

(ii) Fonts (Section 2060(a)(5)) – Although we appreciate the DFPI narrowing down the size fonts that can be used in order to curb providers from making the fonts to large or small in order to deter from the disclosures, we think there should be a little more leeway with the size of the fonts. The reason being is that larger fonts may be required in order to adhere to the federal Americans with Disabilities Act ("ADA").

(iii) Signatures and Disclosures (Sections 2060(a)(2) & 2070)) – We thank the DFPI for implementing our suggestion about only requiring a signature on the disclosure that is consummated, but continuing to require signature lines on all disclosures will cause confusion. Section 2060(a)(2) requires the disclosures to have a specific disclaimer and signature line. We suggest that only the disclosure that is consummated and required to be signed include the signature line. If this change is not made, all disclosure would include a signature line and that will confuse recipients as they will not be required to execute the

[4] Note that each header for the different types of financing is labeled differently, which make it seem as though each type of financing has different requirements or disclosures (e.g., Closed-End Transaction Formatting and Content Requirements; Commercial Open-End Credit Plan Disclosure Formatting; Factoring Disclosure Format; Sales-Based Financing Disclosure Formatting; Formatting and Content Requirements for Lease Financing; General Asset-Based Lending Transaction Disclosure Formatting; and Disclosure Formatting for All Other Transactions). We suggest making the headings more uniform.

majority of disclosures they receive. As explained in detail above, recipients will receive numerous disclosures for each transaction given the current wording of the proposed Regulations. They will think they need to sign all of them given they all would have signature lines. We suggest adding language that a signature line is required only on the consummated disclosure.

C. Specific Disclosure Forms

It is greatly appreciated that the DFPI took some of our recommendations regarding the formatting of the disclosures, deletion of certain descriptions, and instructions limiting the length/breadth of certain explanations. With that being said, additional revisions should be made to make sure the disclosures are clear and not confusing.

1. Closed-end Transactions (Section 2061)

(i) Recipient Funds (Section 2061(a)(2)(C)(ii)(iv)) – The disclosure of any pay-off/pay-down amounts will change daily or weekly as the recipient continues to make payments on the pre-existing financing. What payoff amount will be deemed accurate for disclosure purposes? For example, suppose a recipient accepts a quote and the provider issues disclosures based on a third-party balance as of that day. However, it then takes five (5) days to underwrite the deal and wire funds to the recipient. By that point the payoff balance is less than what was previously disclosed or in the event the recipient failed to make a payment, the amount previously disclosure could be higher. Would the provider need to re-disclose everything at that time? This seems unworkable and hopefully not what the DFPI intends. Clarity is required on this point. Additionally, what if a disclosure is accurate and the provider is ready to wire funds but cannot do so as they do not have a signed copy of the disclosures back from the recipient. If the recipient takes five (5) days to sign and return the disclosures, the payoff amount has changed. The provider would arguably then violate the proposed Regulations unless new disclosures are provided. This may create a never ending cycle as recipients simply may be unable to return signed disclosures the same day they are provided. These timing issues must be addressed. This is exactly why TILA does not require disclosures for non-real estate secured transactions to be signed. Imagine if every Schumer Box disclosure for credit card offers had to be signed. The credit card industry could not function. By adopting TILA-like calculations and disclosures but then ignoring the timing and process followed by TILA is creating material conflicts in the proposed Regulations. TILA is well balanced and has been thought through over decades of litigation and revised regulations and public comment. To ignore the lessons learned from TILA is foolish. We strongly urge you to follow TILA in every regard possible (*e.g.* such as timing of disclosure, signatures, prepayment description, etc.). Failure to do so will lead to confusion, conflicting practices amongst providers, undue litigation and potentially legal challenges to the proposed Regulations.

(ii) Prepayment (Section 2061(a)(8)(9)(10)) – Our concerns from our prior comments surrounding the description of prepayment have not been addressed. TILA chose to require a simple statement about prepayment penalties as opposed to requiring disclosure of amounts because doing so creates confusion. For example, the proposed Regulations refer to prepayment fees being fees other than accrued interest. What is accrued interest? In an environment such as commercial lending where there is no applicable maximum rate, no rate calculation restrictions or state prepayment requirements, the parties are free to contract when "interest" accrues. In a fixed fee transaction, the contract can clearly state that all fees are earned on day one and therefore accrue immediately upon closing of the transaction. In this scenario, all "interest" has accrued as of the end of day one and there is no prepayment penalty. As such, under the proposed Regulations, a provider could legally disclose that there are no prepayment fees if the contract provides all fees are earned on day one. The recipient is then further misled by the disclosures when the next row provides that there are no additional fees for prepayment. In this scenario the disclosures make it appear as if there is a discount for repaying early when there is in fact no such discount. Given this, we believe the better approach with respect to prepayment penalties is to have a more definitive statement about them rather than a calculation and a disclosure amount that can be easily manipulated. We suggest you follow TILA's lead here and simply require the following disclosure: "There is no discount or rebate for paying early" or "Paying off early will save you fees." "Please review your contract carefully to better understand the benefits, if any, of paying off early."

(iii) Non-interest Finance Charge (Section 2061(a)(9)) – This Section discuses a "non-interest finance charge" but does not define what constitutes a non-interest finance charge. Without a definition to what a non-interest finance charge is, providers will calculate this differently which means that recipients will not be able to compare products. Additional clarity is required in order to accurately present this disclosure.

(iv) Average Monthly Cost (Section 2061(a)(11)) – As this issue has not been addressed, we will reiterate the need to delete this section. The disclosure of the monthly cost for a non-monthly pay product does not implement, interpret, or make specific any provision of SB 1235. Requiring this disclosure will not only be inconsistent with SB 1235 but it will do more harm than good. In fact, this disclosure was not mentioned at any of the hearings for SB 1235, was never proposed by Senator Glazer and was never included in any of the model forms Senator Glazer prepared for the hearings and debates on SB 1235. In fact, this disclosure was considered and rejected when the legislation was being drafted. In addition to this disclosure simply not being permitted under SB 1235, adding it would frustrate the purpose of SB 1235 as it detracts from other disclosures that the California Legislature deemed to be more meaningful. It is unclear how disclosing an inapplicable and hypothetical payment amount would be useful information to a recipient. More importantly, the disclosure seems likely to cause confusion given that the information would conflict with the written terms of the commercial financing agreement. Moreover, the disclosure of the average monthly cost is disclosed before the actual payment frequency in the proposed disclosures. This is extremely problematic because the first payment amount disclosed is not the actual payment amount. We would highly recommend this disclosure be removed as it is not necessary or permitted. Because this regulation is inconsistent with the statute enacted by SB 1235, it violates the APA Consistency standard.[5] The regulation also violates the APA Necessity standard.[6] The regulation is not within the scope of authority granted by SB 1235, in violation of section 11342.1 of the APA. It is not reasonably necessary to effectuate the purpose of the statute, in violation of section 11342.2 of the APA.[7]

Additionally, the proposed Regulations require only that the "Average Monthly Cost" be disclosed. How is the average monthly cost calculated? Is the disclosure amount the amount of the monthly cost only (the monthly finance charge) or the total amount to be

[5] CA Government Code § 11349(d)
[6] CA Government Code § 11349(a)
[7] CA Government Code § 11349(a)

paid each month (principal and interest)? Monthly cost is not defined in the proposed Regulations. We assume you intend for the total monthly payments to be disclosed and not just the average monthly finance charge but that is not what the current wording requires.

2. Commercial Open-End Credit Plan Disclosure Formatting (Section 2062)

(i) Finance Charge and Estimated Total Payments (Sections 2062(a)(5)(6)) – Both of these Sections require that a provider provide language stating "…based upon assumptions described above." However, there is no explanation as to what those assumptions are referring to. This needs to be further clarified so that a provider understands what is required in this section.

(ii) Prepayment (Section 2062(a)(10)(11)(12)) - Please see our comments in above under Closed-End Transactions referencing Section 2061(a)(8)(9)(10).

(iii) Non-interest finance charge (Section 2062(a)(11)(A)) - Please see our comments in above under Closed-End Transactions referencing Section 2061(a)(9)(A).

(iv) Average Monthly Cost (Section 2062(a)(13)) - Please see our comments in above under Closed-End Transactions referencing Section 2061(a)(11).

3. Sales-Based Financing Disclosure Formatting (Section 2065)

(i) Finance Charge (Section 2065(a)(4)(c)) – This Section requires that a provider explain how the finance charge was calculated; however, this explanation is not required for Closed-end transactions nor for Open-end transactions. We would suggest deleting the requirement for the explanation as to the calculation as this is not required in other sections. Note that such an explanation is not required under TILA.

(ii) Prepayment (Section 2065(a)(9)(10)(11)) - Please see our comments in above under Closed-End Transactions referencing Section 2061(a)(8)(9)(10).

(iii) Non-interest finance charge (Section 2065(a)(10)(A)) - Please see our comments in above under Closed-End Transactions referencing Section 2061(a)(9)(A).

(iv) Average Monthly Cost (Section 2065(a)(12)) - Please see our comments in above under Closed-End Transactions referencing Section 2061(a)(11).

(v) Estimated Total Payments (Section 2065(a)(6)) – It is unclear based on the language whether or not this refers to the number of estimated payments a recipient will make (*i.e.*, Estimated 52 Payments) or whether it refers to the estimated payment amount of all payments combined (*i.e.* $50,000 worth of payments). We believe the intention is to be the estimated number of payments and suggest this be clarified.

D. Estimates – Sales Based Financing – Historical Method (Section 2091)

While we believe the DFPI attempted to fix this Section based on our previous comments, the language still precludes a provider from utilizing different number of months based on estimated term. This section should be amended to permit providers to use a set number of historical months of data they collect based on financing amount, industry ***and term***. As currently drafted the proposed Regulations only permit this for the financing amount and industry type. There is no rational basis to require a provider to perform the disclosure calculations based estimated monthly sales for an industry type or financing amount but not an estimated term. Typically if a provider offers an eighteen (18) month term, the provider requires twelve (12) months of bank statements but for a six (6) month term, the provider typically requires four (4) months of bank statements. Based on the wording of the proposed Regulations, if two (2) different recipients applied for financing and both recipients were in the same industry and requested the same loan amount, but the only difference was the estimated term, a provider would be required to use the same number of bank statements for calculation purposes for both recipients even though the estimated terms are different. We suggest changing the proposed Regulations to read "a provider shall fix the number of months considered to determine the recipient's average monthly historical sales, income, or receipts for all transactions, or by recipient industry, estimated term, or loan size." This would allow for flexibility for providers and is consistent with current industry practices.

Secondly, there may be instances where a provider receives more than the required amount of statements to calculate the estimated term. This may cause issues as the provider will only be permitted to use the number of months specified in the proposed Regulations even if the additional monthly data collected establishes that that estimate is incorrect. There is no guidance in the event that the provider is calculating the estimated term based on the required amount of bank statements, but the provider knows that the calculation will be incorrect because it received more than the required amount of bank statements.

Moreover, this Section does not establish any distinction for new and renewal transactions. If a provider requires twelve (12) months of transactions history for a new deal, they may very well require only two (2) months if that customer renews with them. They already have a track record with the customer and there is no need for additional statements. We suggest this section be amended to apply to only new transactions to resolve this issue.

Finally, the language that was added in Section 2091(b)(2) states "or by a recipient industry or **loan size** (or both)" (emphasis added). This is extremely problematic as this Section is strictly for Sales-Based Financing and not Closed-End Transactions. We recommend deleting the word "loan" and use "financing" instead.

E. Annualized Rate Disclosure (Section 3000)

We addressed this Section in prior comments as it is unnecessary and requires additional and unnecessary disclosures. Section 3000 simply requires providers to disclose an APR when "extending the specific commercial financing…" which is different language than the definition of "at the time of extending a specific commercial financing offer". The word "offer" is not included in Section 3000 so it is not subject to the definition of "at the time of extending a specific commercial financing offer." As it is currently drafted, Section 3000 would require a standalone APR disclosure because of the phrasing in this Section. APR disclosures are already required in each of the transaction specific form requirements. Is this requirement supposed to be additive? It seems duplicative and unnecessary. If this is some technical requirement given the structure of the applicable law or proposed Regulations, we suggest you add a phrase that this is not an additional disclosure requirement. Alternatively, we suggest the language be changed to "Any provider who extends a specific offer of commercial financing to a recipient shall, at the time of extending a specific commercial financing offer, disclose to the recipient the annual percentage rate." If instead this is an additional APR disclosure requirement, please provide more detail on when this would be required and how it would be disclosed. The regulation violates the Necessity standard of the APA, and it is not reasonably necessary to effectuate the purpose of the statute.[8]

F. Calculation of Annual Percentage Rate (Section 3001)

As we have argued in the other comment submissions we have provided on this topic, we do not believe APR is the best metric and will actually cause more confusion. We incorporate our

[8] CA Government Code § 11349(a)

prior comments provided to you into this letter. However, given the apparent decision to proceed with APR, we once again have the following comments on this section.

Section 3001 covers the calculation of the APR and states that the APR will be calculated in accordance with Appendix J, 12 C. F. R. Part 1026 (effective December 30, 2011). This reference raises two material points:

1. It does not address amendments. If Appendix J is amended, are providers to ignore any such amendments and follow the language that exists as of December 30, 2011? It seems this section should incorporate amendments after December 30, 2011.
2. Part 1026 specifically covers only closed-end transactions. It does not apply to open-end transactions. This is a material problem as the proposed Regulations will require open-end products to use TILA closed-end calculations. Considering TILA has specific calculations for open-end credit, we suggest the APR for open-end products be calculated in accordance with the open-end sections of TILA (*See* 12 C.F.R. § 1026.14).

While we appreciate the deletion of Section 3001(c), there is now a complete absence of any type of assumption for collection of payments. While TILA (12 C.F.R. § 1026.17(c)(3)) permits most creditors to ignore certain items when making calculations, it does not permit repayment terms to be based on payments being made every day. Moreover, TILA only takes into account weekday payments and not weekend payments. Because there is no current calculator created that providers can use for this calculation and no guidance under TILA for daily payment products, each provider may make different assumptions leading to disclosures that are not comparable. In order to have a more uniform disclosures, the DFPI should create a calculator that all providers must use to calculate rate.

The manner in which APR is addressed under the proposed Regulations creates inherent conflicts with TILA's APR. You can now have a consumer and a business get the exact same financing offer (one under TILA and one under the proposed Regulations) and the APR will be different. You can also have a business get the exact same product offering but one from a bank and one from a non-bank and the APR will be different (the bank will likely follow TILA's calculations). We believe this creates a conflict with TILA and that the TILA APR provisions will preempt the APR provisions in the proposed Regulations. Although TILA exempts business transactions from the APR disclosures, it still makes it clear that States cannot mandate inconsistent APR calculations or disclosures. 12 C.F.R. § 1026.28(a)(1) provides that:

> . . . State law requirements that are inconsistent with the requirements contained in chapter 1 (General Provisions), chapter 2 (Credit Transactions), or chapter 3 (Credit Advertising) of [TILA] and the implementing provisions of this part are preempted to the extent of the inconsistency. A State law is inconsistent if it requires a creditor to make disclosures or take actions that contradict the requirements of the Federal law. A State law is contradictory if it requires the use of the same term to represent a different amount or a different meaning than the Federal law, or if it requires the use of a term different from that required in the Federal law to describe the same item.

Comment 2 to this section explains that laws that would be preempted include:

> i. A state law that requires use of the term finance charge, but defines the term to include fees that the Federal law excludes.
>
> ii. A state law that requires a label such as nominal annual interest rate to be used for what the Federal law calls the annual percentage rate.

The proposed Regulations do precisely this. The proposed Regulations mandate use of APR but then change how APR is calculated, create new disclosures and APR calculations called estimated annual percentage rate (if a phrase such as nominal annual interest rate is preempted by Regulation Z, clearly the phrase estimated annual percentage rate is preempted) and requires closed-end calculations for open-end transactions. APR and finance charge are terms of art created by TILA and Congress wanted the terms to be protected so that the disclosures would not lose meaning by States redefining them and then using the same terms in other contexts. While TILA applies mostly to consumer credit transactions the preemption provisions are not limited to just consumer credit transactions. Rather, the provisions of TILA addressing preemption with respect to APR and finance charge are not limited to consumer credit transactions. *See* 15 U.S.C. § 1610(a)(1). It should be noted that when TILA or Regulation Z intend for the preemption rules to be limited only to consumer credit transactions, they expressly state so. For example, Comment 2 to 12 C.F.R. § 1026.28(d) provides that preemption for credit card and charge card rules applies only to consumer transactions and not to business transactions. There is no such limiting language for preemption of inconsistent APR and finance charge disclosures required by State law. The regulation violates the APA Consistency standard.[9]

G. Duties of Financers and Brokers

Section 3023(a)(3) requires that a financer maintain a copy of the "evidence of transmission of the disclosure." There is no description as to what would constitute "evidence of transmission." Would a copy of the sent email or facsimile be sufficient or is there something else specifically that the DFPI is looking for the provider to maintain? Moreover, in the event the broker fraudulently creates an "evidence of transmission," is the provider liable for storing that transmission or not being able to determine if it is fraudulent? Just as a waiver of liability is given to brokers for potentially providing recipients with misleading or incorrect disclosures from the provider, a provider should be provided with a waiver of liability if the broker fraudulently creates the transmission or alters it in anyway. The regulation violates the Clarity standard of the APA.[10]

Additionally, section 3023(a)(4) requires the financer to develop procedures reasonably designed to ensure recipients receive the disclosures from the broker. This will be practically impossible to accomplish based on how this section is structured. We believe this will work better if you require each financer to provide a copy of the disclosures to the recipient at or before consummation if the financer has not previously provided the disclosures to that recipient. This will make sure recipients always get a copy directly from the financer.

H. Other Laws (Section 3024)

This Section is extremely problematic because although required language is not evidence that a financing contract is a loan, the language can be used in the totality of the circumstances. This just invites litigation. After all, a provider would only be disclosing an estimated term and rate as the disclosure law requires that they do so. To then permit this to be used against them in court to argue a non-loan transaction is actually a loan is unheard of. This Section should either be deleted or amended to make it apply only to the type of disclosure provided (if a sales based financing product uses the closed end product disclosures that could be used as evidence the transaction is a loan).

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[9] CA Government Code § 11349(d)
[10] CA Government Code § 11349(c)

I. Tolerances (Section 3026)

Section 3026(a)(1) states that the tolerances are for the annual percentage rate disclosed pursuant to Section 3000. It is unclear why the tolerances should apply only to the APR disclosure in Section 3000 and not to all APR disclosures throughout the proposed Regulations. The tolerances should apply to all APR and estimated APR disclosures in the proposed Regulations. We suggest making the tolerances applicable to all disclosed APRs or estimated APRs throughout the proposed Regulations.

III. CONCLUSION

Thank you once again for considering our comments. As always, we remain committed to working with you to implement regulations that provide value to small businesses. We hope you appreciate our comments. We are motivated to make sure the final regulations work, provide value and assist small businesses. We would be happy to discuss these matters with you. You may reach me at 240-482-4684.

Very truly yours,

[redacted]

Joseph D. Looney
General Counsel