

4/26/21

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

**By Electronic Mail:** [regulations@dfpi.ca.gov](mailto:regulations@dfpi.ca.gov)  
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Re: **[Comments on the Modifications to the Proposed Regulations on Commercial Financial Disclosures \(PRO 01/18\)](#)**

Dear Ms. Sandoval:

On behalf of Strategic Funding Source, Inc. doing business as Kapitus (Kapitus), we would like to thank the Department of Financial Protection and Innovation (DFPI) for the opportunity to provide the following comments on the proposed rules relating to the implementation of SB 1235.

Kapitus is dedicated to providing capital to small businesses through technology-enabled underwriting. In California, we currently offer two financing products directly to small businesses. First, Kapitus originates commercial loans under a CFL license. In the terminology of the proposed regulations, these loans are classified as “closed-end transactions.” Second, Kapitus enters into contracts with small businesses where it purchases a percentage of a small business’s future income. In the terminology of the proposed regulations, these agreements are classified as “sales-based financing.”

As an initial matter, Kapitus would like to thank the DFPI for incorporating many of the suggestions we, as well as many others, raised during earlier rounds of the rulemaking process. These changes have improved the proposed regulations substantially. Despite these positive changes, however, there are a few critical issues we want to bring to your attention. The first involves the calculation of the annual percentage rate and the need for clarification for providers who collect payments on a daily, weekly, or bi-monthly schedule. The second involves Section 3026 and the need for providers to have the ability to seek assistance from the DFPI. The third involves Section 3027 and the need to make sure recipients are provided with disclosure of all funds paid to brokers regardless of how they are defined or classified. To this end, Kapitus offers the following comments and

recommendations on the proposed regulations and, consistent with the request from the DFPI, is limiting its comments to the changes to the regulations most recently proposed.

### **Section 3001. Calculation of Annual Percentage Rate (APR)**

The revisions to Section 3001 deleted subsection (c), an important provision which allowed the provider to assume that payments are collected each calendar day for purposes of the mandated APR calculations. As a provider who offers products, which include daily, weekly, bi-monthly, and monthly payment schedules, this provision was critical for standardizing the APR calculations. The APR calculations reference and incorporate portions of Regulation Z, but all calculations under that regulation are based on a monthly payment schedule. Deleting the provision that allowed an assumption of daily payments collected on a 365-day basis renders it impossible for a provider such as Kapitus, which offers products that call for payment on a daily weekly, or bi-monthly basis, to ensure it is compliant with the APR calculation called for in Section 3001.

To calculate APR, a provider must make certain assumptions based on the frequency of payments: daily, weekly, or bi-monthly. Under the proposed regulations, Kapitus would have to calculate APR under Regulation Z but to do this, it would have to perform an additional step for recipients who are not on a monthly payment schedule. The regulations appear to require that a provider either make assumptions as to how Regulation Z would apply to payments are collected on a less than monthly basis, or assume that all payments collected in a single month are collected on a single payment date per the standard calculations set forth in Regulation Z. Because paragraph (c) was deleted, Kapitus is left without the guidance necessary to understand how the APR calculation under Regulation Z should apply to non-monthly payment products.

Kapitus urges either the reinstatement of the deleted subsection (c), or an addition to the regulation clearly stating how the APR calculation should be done for products with payment daily, weekly, or bi-monthly payment frequencies, which are not addressed in Regulation Z. The alternative of allowing providers to determine on their own how the calculation should be done will lead to inconsistent assumptions and will undermine the goal of clarity for small businesses comparing products, as the lack of clarity in the calculation will lead to differences in the stated APR. Such inconsistency is detrimental to small businesses, the intended audience for the disclosure.

### **Section 3026. Tolerances**

Kapitus recognizes that the DFPI added Section 3026, which discusses tolerances and adds some language limiting liability, but Kapitus continues to be concerned about the inherent difficulty in calculating APR and the use of estimates, and the reality that these estimates could differ from the actual cost of the financing. For this reason, Kapitus urges that the DFPI add language to allow providers the ability to seek guidance from the DFPI (perhaps through a designated individual or office)



regarding the methods being used to comply with the DFPI's regulations. This is essential to ensure that Kapitus is using the correct methods to provide the disclosures that the DFPI is mandating and to ensure that recipients have the necessary information to compare products across providers.

Kapitus recommends the addition of Section 3026(d):

"A provider or financier shall have the ability to consult with the DFPI on the methods of estimates and calculations called for under this Subchapter and rely on the guidance offered in writing by the DFPI regarding interpretive questions as safe harbor."

### **Section 3027. Funding Recipient Will Receive**

Kapitus applauds the additional disclosures set forth in Section 3027. Kapitus believes, however, that these additional disclosures should be included in the main disclosure (as part of Sections 2061-2068) rather than as a separate document. This would ensure that recipients have all necessary information upfront and do not miss these critical additional disclosures.

Kapitus also proposes that an additional disclosure be added as a line item in Sections 2061-2068. The purpose of this additional disclosure is to ensure that recipients are aware of **all** amounts paid to brokers in connection with an offer of commercial financing, provided the amount paid is tied directly to or contingent upon some aspect of the specific commercial financing offer made to the recipient. Recipients should be made aware of all amounts paid to brokers regardless of how these amounts are defined or classified.

Such disclosure is critical for recipients to be able to differentiate between costs imposed by a provider and costs imposed by a broker. Such disclosure allows recipients to immediately identify, and be able to dispute, excessive or additional charges that may be imposed by a broker after the disclosures are sent from the provider. These additional charges are often through a deduction from the recipient's account and often described as a broker fee to the recipient. Recipients do not question these additional fees thinking that they are the only fees a broker is receiving. Clearly disclosing what a broker is getting paid from a provider will help to eliminate the practice of charging additional and unwarranted fees, and make the broker's financial incentives clear. Such a disclosure also will work to prevent unscrupulous brokers from steering their customers to financing options that are most lucrative for the broker, for example, those with the highest commission (whether the commission is a deduction from the amount financed or an increased finance charge or some other amount based on the terms of the specific offer of financing) rather than financing that represents the best option for the recipient.

Although Kapitus believes this was the intent of Section 3027, and that Section 3027 is an important step, as currently drafted, the additional disclosures in Section 3027 do not accomplish the goal of making sure recipients are aware of **all** funds paid to brokers. Section 3027 provides for disclosure of the amount of deductions



from the amount financed, which is important. It does not, however, provide for disclosure of all funds a recipient will pay, directly or indirectly, to the broker based on the offer selected. Commissions charged by the provider or paid to the broker are not always a deduction from the Funding Provided as defined in Section 3027. Rather, in some cases, these commissions are paid based on the finance charge the customer accepts; a higher finance charge or other product attribute results in a larger commission paid to the broker. Funds paid to a broker that are included in the finance charge as an increased rate rather than deducted from the Funding Provided would not be disclosed under Section 3027 as currently drafted. There is a simple fix to address this concern.

Kapitus recommends that the DFPI redefine “funds paid to brokers” as stated below and add this amount as a separate line item in the disclosures set forth in Sections 2061-2068.

(32) Funds paid to brokers means the total amount of compensation that a provider pays to a broker in connection with the financing.

### **General: Implementation Date**

The regulations require complicated calculations and estimates as currently written and will require significant technology changes prior to implementation. For its sales-based financing products, Kapitus will have to determine if it should use the historical or underwriting method. For the historical method, as stated in the draft regulations, Kapitus will have to determine how to calculate the estimated monthly sales, income, or receipts projection as well as how to determine the number of months on which to base the recipient’s average monthly historical sales, income, or receipts. Kapitus will have to determine if this should be by industry or loan size or both. Kapitus will have to determine if the period of data shall be four months or twelve months or something in between. In determining whether to exclude a month from the average calculation, Kapitus will have to determine if the decreased monthly sales arose from a cause, such as a natural disaster or uncommon business interruption, that is unlikely to recur during the performance of the contract.

For the underwriting method, as stated in the draft regulations, Kapitus must calculate the disclosures using an “internal estimated sales, income, or receipts projection” through the particular payment channel or mechanism using the best information available to it. Kapitus must determine what is the best information available to it. Under this underwriting method, Kapitus also must conduct audits of its commercial financings once every four months.

All of this will require significant analyses and putting in place additional processes and procedures, including many technology changes. Kapitus requests that (1) the DFPI provide at least 6 months to implement any required changes after the final regulations are released; and (2) the DFPI allow licensees the ability to ask for an extension beyond this 6-month period if it is necessary due to challenges with



estimates, calculations, and/or technology, provided that the provider has made good faith efforts to comply as demonstrated to the DFPI.

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In sum, Kapitus supports disclosures that provide recipients the ability to compare different products. Kapitus believes that these disclosures should be clear, consistent, and complete. Kapitus requests (1) that the DFPI issue more guidance on the calculations of APR to prevent providers from using inconsistent assumptions, (2) that providers have the ability to seek guidance from the DFPI regarding the methods used to comply with these regulations, and (3) that the DFPI require additional disclosures so that recipients are aware of **all** funds paid to brokers in connection with an offer of commercial financing regardless of how these amounts are defined or classified.

Again, Kapitus would like to thank the DFPI for taking the time to receive and review its comments. Kapitus looks forward to working with the DFPI on the proposed rulemaking implementation of SB 1235. If the DFPI has any questions or needs additional information, please feel free to contact me.

Sincerely,

**MICHAEL JESSE CARLSON**

Senior Vice President and General Counsel

