



53 State Street
Floor 20
Boston, MA 02109

ashapiro@forwardfinancing.com

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Via e-mail to (regulations@dfpi.ca.gov), [REDACTED]@dfpi.ca.gov and [REDACTED]@dfpi.ca.gov

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

Re: Comments on Second Modification to Proposed SB 1235 Commercial Financing Disclosure Regulation (File no: PRO 01-18)

Dear Acting Commissioner Schultz:

Thank you for requesting comments on the second modification to the proposed commercial financing disclosure regulations (“proposed regulations”). Forward Financing LLC appreciates this opportunity to comment on the proposed regulations.

Forward Financing is a nationally recognized fintech company that provides fast and flexible working capital to small businesses across the country. By combining proprietary technology with a team of small business financing experts, we deliver same-day funding with the speed and simplicity business owners need to succeed and grow.

Since its founding in 2012, Forward Financing has provided 30,000 businesses with over \$1.1 billion in funding to help them purchase inventory, hire employees, expand their operations, and open new locations. These small businesses include restaurants, nail salons, small construction firms, transportation companies, and specialty contractors such as electricians and plumbers. Our small business customers are often turned away by traditional lenders due to lack of time in business, uneven revenue flow, or blemished credit. As an alternative to traditional loans, we provide our customers with sales-based financing.

Through sales-based financing, customers can secure upfront capital in exchange for a certain percentage, typically 10%, of their monthly revenues until the amount purchased is remitted in full. Unlike with a traditional loan, with sales-based financing, if a customer’s revenue decreases, its required periodic payments to us also decrease. Our contracts also have a set expiration of three years, after which customers have no further obligation to make payments to

us. Thus, if a customer's revenues remain at a decreased level so that at the end of three years it still has not remitted the full amount purchased, Forward Financing will lose its right to collect anything further from it. Moreover, we do not charge prepayment fees or penalties, and our financing contracts include discounts for prepayments of amounts owed.

Customers find this flexible financing attractive as they grow their businesses. Additionally, the risk lies on us - if a customer goes out of business before being able to pay us their contracted amount, or the contract expiration date passes, Forward Financing bears the risk of loss. There is also no personal payment guarantee making an individual responsible for the payments.

The fixed amount we charge allows our customers to easily determine the actual dollar amount the financing will cost, and the more frequent payment schedule ensures the business is not overwhelmed by large monthly payments. 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.

Forward Financing supports disclosures to customers and ensures that its sales-based financing customers receive appropriate information on which they can make well-informed decisions. We agree with the general objectives of the DFPI to do likewise, but believe the proposed regulations are overly complex and require disclosures which may confuse, rather than help, customers. Our comments address several issues raised by the proposed regulations.

Total Financing Percentage

The APR formula, including the estimation of a customer's sales, income or receipts, and the required disclosures under the proposed regulation are so complicated, and many terms so similar, a customer could easily be perplexed and not know how to interpret them. Moreover, because sales-based financing products such as those we provide are typically repaid in the 4-8 month range, the APR will appear to be very high when compared to longer term financing. But to say that APR alone provides an apples-to-apples comparison to other financing products would be ignoring the key benefit of sales-based financing – the fact that payments due are directly proportionate to revenues earned by the small business, and a business will not have to make any payments to the extent it is not making revenues.

In 2010, the Dodd-Frank Act amended the Truth in Lending Act ("TILA") to require a simplified rate disclosure, the Total Interest Percentage ("TIP"), in response to a demand for a clearer disclosure that consumers could more easily understand and use in comparing mortgage loan options. Dodd-Frank Wall Street Reform and Consumer Protection Act, § 1419(19). TIP is the total amount of interest that a consumer pays over the life of a mortgage loan expressed as a percentage (e.g., a \$500,000 mortgage loan with \$250,000 of interest paid over the life of the loan would have a TIP of 50%).

The discussion leading up to TIP included a significant amount of commentary that few consumers read through or understood, including voluminous and confusing APR and finance charge disclosures. Congress did not replace those disclosures but added the simpler TIP

disclosure. Any revision to the proposed regulations should include a disclosure similar to the TIP standard. The new disclosure could be called the Total Financing Percentage (“TFP”), with the total amount of financing fees paid by a customer expressed as a percentage of the amount financed.

Recommendation: For the reasons set forth above, we suggest as an *alternative or additional disclosure option* for sales-based financing transactions, disclosure of a rate comparable to TIP. This could be called a Total Financing Percentage (TFP), and would help present a more complete picture of a sales-based financing transaction than would APR.

APR Tolerances

For sales-based financing disclosure purposes, Section 3001 of the proposed regulations requires that the APR be calculated in accordance with TILA consumer regulations. Section 3001 also incorporates by reference the TILA regulations. To accurately reflect a sales-based financing transaction with an expiration date in its financing contract (such as that of Forward Financing), financiers offering such a product should be allowed to disclose an APR range, instead of a static APR. Using a static APR does not adequately take into account the longer expiration of certain sales-based financing agreements, nor their fluctuating characteristic.

Moreover, Section 3026 specifies that an APR calculation will be considered accurate if it is more than 1/8th of 1 percentage point above or below a correct APR calculation. While this may be an appropriate “safe harbor” measure for consumer loans, the variables involved in developing an APR for a sales-based financing make it an invitation for legal and regulatory disputes. Estimating sales, income or receipts is not a precise exercise, and other elements like “reasonably anticipated true-ups” underscore the need for a standard that reflects the nature of computing an APR for sales-based financing. These issues present an invitation for plaintiffs’ attorneys to capitalize on inadvertently inaccurate APR calculations.

Recommendations:

- For sales-based financing transactions that have an expiration date, the financier should be permitted to disclose an APR range. That is, if the original estimated payment period is 6 months, and the longest permitted collection period is three years, then the financier should be permitted to disclose APR as “Estimated APR is XX% to YY%.”
- In addition, to avoid an onslaught of litigation against well-meaning financiers who make every effort to comply with the regulations, the APR tolerance measure should be eliminated, or at least it should be specified that a miscalculation cannot be grounds for private litigation.

Historical and Internal Underwriting Methods to Estimate Income

Section 2091 of the proposed regulations, the “historical” method to estimate a financing applicant’s income, requires a financier to analyze between four and twelve months of an applicant’s sales, income or receipts, and focuses only on those elements. This methodology

does not reflect how Forward Financing makes decisions on financing applications and would unnecessarily limit how a financier like Forward Financing assesses a customer's future financial prospects.

When underwriting financing, we perform a multi-faceted analysis, which includes analysis of the customer's industry, geography, time in business, whether or not the business is seasonal, history of bankruptcy or other financial events, along with recent receipts, among other things. We typically review three months of an applicant's receipts and strongly believe this number serves the best interests of our customers, whose primary interest is to receive financing expeditiously rather than enduring the added burden of providing additional bank statements.

Ultimately, the number of months of sales, income or receipts to use should be a business decision for any financier. Based on our numerous years in business, we believe three months is sufficient to gain an understanding of a business' likely future revenue stream. Moreover, in the event a customer's receipts unexpectedly fluctuate, there is a true-up provision in our contracts to ensure that the amount of the customer's payments reflect its actual receipts. We strongly recommend that a further revised proposed regulation account for different business models and include, at least, a range of three months to twelve months sales, income or receipts.

Although the proposed regulations provide an alternative method to estimate income - the "underwriting" or internal method - this method involves so many steps and variables that its use is questionable. The frequent audits of paid off transactions reflecting this method and the calculation of retrospective APRs make this method expensive and especially cumbersome.

Recommendation: Omit the requirement to provide 4-12 months of bank statements for sales-based financing, or alternatively, reduce the requirement to 3 months' statements.

True-ups

Included in the required disclosures under Section 2065 are the "date and amount of any reasonably anticipated true-ups." Section 2057(27) defines "reasonably anticipated true-up" as any true-up a financier "has a reasonable basis to expect ... during the term of the contract, accounting for past performance of similar contracts"

Forward Financing does not anticipate any true-ups when it provides sales-based financing. True-ups may occur, but by definition, they are unexpected. A financier who anticipates during underwriting that a customer will require a true-up should provide for a different periodic payment amount at the outset. Even if somehow it made sense to "anticipate" a true-up, predicting the date and amount of a true-up would be speculative at best.

Recommendation: We recommend deleting the anticipated true-up disclosure, but retaining the disclosure regarding an explanation of a financier's true-up policy.

Itemization of Amount Financed and Broker Fees

Section 3027 requires financiers like Forward Financing to provide certain disclosures in either of two separate charts if the amount financed is greater than the funds received by the recipient. Both charts include disclosure of a brokerage fee paid to a broker and refer to the fee as a “prepaid finance charge.” The proposed regulations define prepaid finance charge as fees paid separately to the financier by a customer before or at consummation of a transaction, or withheld from the financing at any time.

The premise that broker fees are always either paid upfront by the customer, or withheld from the financing amount provided to a customer, is not true. Forward Financing, for example, pays its broker fees in several different manners.

- First, it pays transaction-based commissions out of the difference between the amount financed and the amount of future receivables we purchase from the customer. By way of example, assume a customer finances \$10,000 with us in exchange for providing us with \$13,000 of their future receivables. At the time of contracting, assume we deduct \$100 in processing fees, so that the customer actually receives \$9,900. Thus, the customer is ultimately receiving \$9,900 and we will ultimately be paid \$13,000 in future receivables. It is from that \$3,100 difference that we later pay any transaction-based commission to brokers.
- Second, Forward Financing pays brokers “volume-based bonuses” – that is, additional fees based on the broker reaching a certain level of funded transactions.
- Next, from time to time, Forward Financing pays sales-performance incentive funds (or “SPIFs”) to brokers.

As such, neither of the sample charts referenced in Sections 2065 (2)(C) and 3027(b) applies to our situation, and there is no way for us to provide a disclosure chart “substantially similar” to either of them, as Section 3027(a) requires.

Recommendation: In the situation (such as ours) where various broker fees are paid by the financier from its profits *after* a transaction is consummated, the current draft regulation should be modified to allow an Itemization of Amount Financed as follows:

ITEMIZATION OF AMOUNT FINANCED	
1. Amount Given Directly to You	\$9,900
2. Property Valuation Fee/Admin Fees	\$100
3. Amount Financed For You	\$10,000

Status as a Financier

Applying consumer loan disclosure standards raises significant questions regarding the status of commercial financing transactions under California law. Section 3024 indicates that the proposed regulations “are not intended” to “clarify or interpret” California laws defining “loan,

sale, or lease” in connection with financing transactions covered under the proposal. It further indicates that the proposed regulations do not affect the authority of the Department of Financial Protection and Innovation regarding other laws under its jurisdiction. This section should also make clear that the imposition of consumer loan protection standards and requirements to commercial financing transactions does not mean such transactions are loans under California law.

Recommendation: We recommend that Section 3024 be amended by adding the following after Section 3024(a):

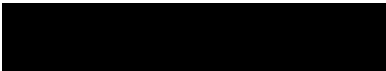
“(b) Compliance of commercial financing transactions with the rules of this Chapter does not change or alter the financing transactions into loans under California law.”

Conclusion

In sum, Forward Financing supports clear, meaningful disclosures that help customers making well-informed decisions about different types of financing options. Given the complexities of the proposed regulations and the need for additional revisions, we recommend the issuance of a further modified proposal for public comment before the adoption of final regulations.

We again appreciate this opportunity to provide comments and suggestions regarding the proposed regulations and thank you for your consideration of them. If you have any questions or comments, please contact me at 617-379-2593 or by email at ashapiro@forwardfinancing.com.

Respectfully submitted,



Alexis Shapiro, General Counsel
Forward Financing LLC