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October 28, 2020

RE: Commercial Financing Disclosures Rulemaking, File No. PRO 01-18

Dear Mr. Carriere,

Today we face the prospect of lasting damage to the small businesses that help produce California's middle class and the fabric of our local communities. When we drive past the closed storefronts in our towns and cities, we need no reminder that small businesses are devastated, desperate for help, and more vulnerable than ever to irresponsible lending.

The Responsible Business Lending Coalition ("RLBC") is grateful for this opportunity to comment on the implementation of SB 1235, which will provide meaningful protection to our small businesses community as it recovers. Additionally, after working over the past year to pass AB-1864 to expand the mandate of your agency, we are delighted to address this comment to the now-renamed Department of Financial Protection and Innovation ("the Department").

We are a coalition representing over 500 nonprofit community organizations, for-profit small business financing companies, CDFIs, advocacy nonprofits, civil rights groups, chambers of commerce, and tens of thousands of small businesses. Many of us came together as signatories of the *Small Business Borrowers' Bill of Rights*, on which Senator Glazer based SB 1235.<sup>1</sup> Together with Senator Glazer and other leaders in the legislature, this coalition supported the bill's passage in overwhelming, bipartisan votes of 72-3 in the Assembly and 20-6 in the Senate.

California's SB 1235 has inspired a wave of small business protection lawmaking across the country, including the New York's *Small Business Truth in Lending Act*<sup>2</sup> passed by legislature in July, and the federal *Small Business Disclosure and Broker Regulation Act*<sup>3</sup> recently introduced in US Congress.

Lawmakers and regulators recognize that small businesses deserve better than the misleading disclosure practices that are degrading the small business financing market today. For small businesses already on the brink of closure because of the COVID-19 pandemic, ending up in an unaffordable credit product because of a lack of price transparency could be the difference between survival and failure.

Lawmakers and regulators also recognize that transparency in small business financing is especially important to communities of color. Federal Reserve research recently concluded that Black and Hispanic entrepreneurs are twice as likely to be affected by "potentially higher-cost and less-transparent credit products."<sup>4</sup> This research specifically identifies merchant cash advance and factoring products as "*potentially higher-cost and less-transparent credit products.*"

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<sup>1</sup> Responsible Business Lending Coalition, "Small Business Borrowers' Bill of Rights."  
<http://www.borrowersbillofrights.org/>

<sup>2</sup> The New York State Senate, "NY State Senate Bill S5470B," March 2020.  
<https://www.nysenate.gov/legislation/bills/2019/s5470>

<sup>3</sup> Congress.gov, "H.R. 7889 - Small Business Lending Disclosure and Broker Regulation Act of 2020," July 2020.  
<https://www.congress.gov/bill/116th-congress/house-bill/7889/text>

<sup>4</sup> Zeeuw, Mels de, Federal Reserve Bank of Atlanta, "Small Business Credit Survey: Report on Minority-Owned Firms," Dec 2019. <https://www.fedsmallbusiness.org/medialibrary/fedsmallbusiness/files/2019/20191211-ced-minority-owned-firms-report.pdf>

The market failures in small business financing today come at great cost to small businesses and California’s economy. The RBLC has estimated that implementing SB 1235 could save 127,000 California small businesses as much as \$1.4 billion to \$12.1 billion annually, with a disproportionate benefit to 11,000 African American-owned businesses and 39,000 Hispanic-owned businesses. This savings to our state’s small businesses can benefit 1.5 million employees and has the potential to create up to 25,000 new local jobs.<sup>5</sup>

A portion of this savings will result from some small businesses, newly empowered to compare the prices of financing products, selecting lower-cost financing options. Other savings may result from financing companies proactively lowering their prices to compete once price disclosure brings price competition to the market. In time, healthy competition in a more efficient financing market may encourage innovations that further lower financing costs or improve product quality.

For reasons like these, the California legislature again took action this summer to protect small businesses from predatory lending by including small business financial protection in AB-1864, which expanded the Department of Business Oversight into the Department of Financial Protections and Innovation. In section 90009(e), the Department is granted rulemaking authority to address unfair, deceptive, and abusive acts and practices (UDAAP) in commercial financing. That rulemaking will be integral to the effective enforcement of the commercial financing disclosure rules discussed here. We strongly urge the Department to undertake the commercial financing UDAAP rulemaking as soon as possible. Diverse stakeholders within California and across the nation are closely following the implementation of this landmark rule.

Below is a summary of recommendations for the commercial financing disclosure rule and associated page numbers that contain a more detailed discussion.

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Attachments:

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<sup>5</sup> Responsible Business Lending Coalition, “Re: Third Invitation for Comments on Proposed Rulemaking Commercial Financing Disclosures, File No: 01-18,” Jan 2020, [http://www.borrowersbillofrights.org/uploads/1/0/0/4/100447618/rblc\\_comment\\_-\\_commercial\\_financing\\_disclosures\\_pro\\_01-18.pdf](http://www.borrowersbillofrights.org/uploads/1/0/0/4/100447618/rblc_comment_-_commercial_financing_disclosures_pro_01-18.pdf)

Appendix B - Redline markup of the rule text, reflecting the recommendations above, as well as several clarifying edits not discussed within this comment letter.

## Elements of the Rules That We Endorse

The Department's proposed rules are thoughtful, detailed, and reflect a great deal of expertise in small business financing. We applaud the Department for the following aspects of the rulemaking:

- 1) Establishes APR as the annualized rate required under SB 1235.
- 2) Covers all small business financing products from non-banks, including loans, lines of credit, merchant cash advances, factoring, lease financing, and products offered through issuing-bank partnerships, as required under SB 1235.
- 3) Times the disclosure to occur at the first "specific offer" of financing, which is early enough for small businesses to use the information in comparison shopping. If the disclosure had been delayed until the "final offer" stage, it would have come too late for many small business applicants to make use of the information.
- 4) Includes disclosure of payment amounts in dollars-per-month to enable applicants to compare payment amounts currently disclosed in formats such as "\$74 per day," "\$2,450 per month," and "15% of sales." The actual payment amount and frequency, if different than once per month, is also included.
- 5) Brings sunshine to the hidden prepayment charges that Federal Reserve research confirms may mislead small businesses today.
- 6) Requires transparent disclosures from financing brokers. This will help small businesses avoid being "steered" into the products that pay brokers the highest fees.
- 7) Closes a loophole that would not have included fees in the APR for lines of credit. By referring 12 C.F.R. part 1026.4 in the discussion of fees<sup>6</sup> that must be included in the APR, the rules prevent high-cost open-end credit products from misleadingly disclosing a 0% APR.
- 8) Permits the "look and feel" of the disclosure to match the rest of the customer experience, to avoid being perceived as irrelevant "fine print."

We commend the Department for continuing to anchor the proposed rules around annual percentage rate ("APR") as the annualized rate required by SB 1235. We recognize that the disclosure of APR is criticized by some, generally by financing companies that charge high APRs and do not disclose them to their customers.

As the Department has recognized, APR is the only established metric that enables informed comparisons of the cost of capital over time and between products of different dollar amounts and term lengths. APR is the time-tested rate that people know and expect, because it is the legally required standard for mortgages, auto loans, credit cards, student loans and personal loans, including short-term loans.

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<sup>6</sup> §3010(a)(1) of these rules



As the CFPB describes on its website, “The APR, or annual percentage rate, is the standard way to compare how much loans cost. It lets you compare the cost of loan products on an ‘apples-to-apples’ basis.”<sup>7</sup>

The value of transparent APR disclosure in small business financing specifically is acknowledged in broad consensus, including:

1. Multiple research studies published by the Federal Reserve<sup>8</sup>
2. The California Department of Business Oversight, in market monitoring activities dating as far back as 2015<sup>9</sup>
3. The Federal Reserve Board of Governors Community Advisory Council<sup>10</sup>
4. The Conference of State Bank Supervisors’ Fintech Industry Advisory Panel
5. 110+ industry and nonprofit signatories and endorsers of the Responsible Business Lending Coalition’s *Small Business Borrowers Bill of Rights*<sup>11</sup>
6. A dozen member companies of the Innovative Lending Platform Association<sup>12</sup>
7. The Bloomberg News editorial board<sup>13</sup>
8. The Bipartisan Policy Center<sup>14</sup>
9. The National Consumer Law Center<sup>15</sup>
10. Former SBA Administrator Karen Mills<sup>16</sup>

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<sup>7</sup> Consumer Financial Protection Bureau, “Credit cards key terms,” [www.consumerfinance.gov/consumer-tools/credit-cards/answers/key-terms/](http://www.consumerfinance.gov/consumer-tools/credit-cards/answers/key-terms/)

<sup>8</sup> Lipman, Barbara and Wiersch, Anne Marie, Board of Governors of the Federal Reserve System, “Uncertain Terms: What Small Business Borrowers Find When Browsing Online Lender Websites,” Dec 2019. <https://www.federalreserve.gov/publications/files/what-small-business-borrowers-find-when-browsing-online-lender-websites.pdf>;

Lipman and Wiersch, Federal Reserve Bank of Cleveland, “Alternative Lending through the eyes of ‘Mom & Pop’ Small-Business Owners,” August 2015. <https://www.clevelandfed.org/newsroom-and-events/publications/special-reports/sr-20150825-alternative-lending-through-the-eyes-of-mom-and-pop-small-business-owners.aspx>;

Lipman and Wiersch, Federal Reserve Board of Governors, “Browsing to Borrow: ‘Mom & Pop’ Small Business Perspectives on Online Lenders,” June 2018. <https://www.federalreserve.gov/publications/files/2018-small-business-lending.pdf>;

Zeeuw (2019)

<sup>9</sup> California Department of Financial Protection and Innovation, “Survey of Online Consumer and Small Business Financing Companies – 01/01/2010 through 06/30/2015.” <https://dfpi.ca.gov/wp-content/uploads/sites/296/2019/02/Survey-Response-Summary-Report-04-08-16.pdf>

<sup>10</sup> See: page 7, Federal Reserve, “CAC Meeting Record 10/05/2018,” Oct 2018.

<https://www.federalreserve.gov/aboutthefed/files/cac-20181005.pdf>

<sup>11</sup> Borrower’s Bill of Rights, “Signatories,” <http://www.borrowersbillofrights.org/signatories.html>

<sup>12</sup> Innovative Lending Platform Association, “Innovative Lending Platform Association,” <https://innovativelending.org/>

<sup>13</sup> Editorial Board, Bloomberg Opinion, “Here’s One Way to Help Small Businesses Survive: Pass Legislation to Protect Them from Predatory Lenders,” Aug 2020. <https://www.bloomberg.com/opinion/articles/2020-08-18/to-help-small-businesses-survive-protect-them-from-predatory-lenders>

<sup>14</sup> Greig, Mills, Snowe, and Walsh, Bipartisan Policy Center, “Main Street Matters: Ideas for Improving Small Business Financing,” Aug 2018. <https://bipartisanpolicy.org/report/main-street-matters-ideas-for-improving-small-business-financing/>

<sup>15</sup> See: Appendix B, Responsible Business Lending Coalition, “Re: Second invitation for comments on proposed rulemaking—commercial financing disclosures, FILE NO: PRO 01-18,” Sept 2019.

[www.borrowersbillofrights.org/uploads/1/0/0/4/100447618/rblc\\_coalition\\_comment\\_on\\_ca\\_dbo\\_small\\_business\\_financing\\_disclosures\\_-\\_pro\\_01-18\\_-\\_sept\\_2019.pdf](http://www.borrowersbillofrights.org/uploads/1/0/0/4/100447618/rblc_coalition_comment_on_ca_dbo_small_business_financing_disclosures_-_pro_01-18_-_sept_2019.pdf)

<sup>16</sup> Mills, Karen and McCarthy, Brayden, Harvard Business School, “The State of Small Business Lending: Innovation and Technology and the Implications for Regulation,” 2016. [http://www.hbs.edu/faculty/Publication%20Files/17-042\\_30393d52-3c61-41cb-a78a-ebbe3e040e55.pdf](http://www.hbs.edu/faculty/Publication%20Files/17-042_30393d52-3c61-41cb-a78a-ebbe3e040e55.pdf)

11. US Treasury officials<sup>17</sup>
12. The New York Department of Financial Services<sup>18</sup>
13. And numerous news articles<sup>19</sup>

Through these rules, the Department has established a framework for APR disclosure that can be followed by financing providers who are unused to disclosing their APRs, so that small businesses can make more fully informed decisions about what financing is right for them.

## Compliance Costs Will Be Low, Savings to Small Businesses High

As financing providers, we believe the cost to providers of complying with this regulation will be small and absorbable. Providing transparency through a simple disclosure will not result in a reduction in access to capital, or in an increased cost of financing for small businesses. The opposite is true -- the greatest financial impact to businesses will be the reduction in financing costs enjoyed by small businesses borrowers.

The cost to financing companies of providing these disclosures will be low. In fact, most commercial financing providers, not to mention all consumer financing providers, already provide some type of analogous disclosures. For example, Federal Reserve researchers compiled a list of the 10 most prominent online lenders and found that most already have some sort of disclosures in place.<sup>20</sup>

Including APR in these disclosures, if it does not appear already, is quite feasible. Indeed, many lenders and some merchant cash advance providers already do include APR in their disclosures.<sup>21</sup> Other merchant cash advance providers calculate what is effectively an APR and advertise their (often high) rates to their investors, but do not disclose those rates to their small business borrowers.<sup>22</sup>

As financing providers ourselves, we find that compliance with the Truth in Lending disclosure requirements for consumer lending do not require any costly third party vendor, specialized software, or similar expense. It is simply a part of the work of compliance staff. Commercial financing companies already have compliance staff to support compliance with the:

- Equal Credit Opportunity Act (ECOA),
- Fair Credit Reporting Act (FCRA),
- Federal Trade Commission Act and Unfair or Deceptive Acts and Practices (UDAP),

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<sup>17</sup> U.S. Department of Treasury, “Opportunities and Challenges in Online Marketplace Lending,” May 2016. <https://www.treasury.gov/connect/blog/Pages/Opportunities-and-Challenges-in-Online-Marketplace-Lending.aspx>; Milano, Jessica, Progressive Policy Institute, “Shining a Light on Small Business Credit: Promoting a Transparent Marketplace,” Nov 2017. [https://www.progressivepolicy.org/wp-content/uploads/2017/11/PPI\\_SmallBizCredit\\_2017.pdf](https://www.progressivepolicy.org/wp-content/uploads/2017/11/PPI_SmallBizCredit_2017.pdf)

<sup>18</sup> Vullo, Maria, New York State Department of Financial Services, “NYDFS: Online Lending Report,” July 11 2018. [https://www.dfs.ny.gov/docs/reportpub/online\\_lending\\_survey\\_rpt\\_07112018.pdf](https://www.dfs.ny.gov/docs/reportpub/online_lending_survey_rpt_07112018.pdf)

<sup>19</sup> See e.g. McClatchy, “Even Finance Whizzes Say It’s Impossible to Compare Online Small Business Loan Options.” June 2018. <https://www.mcclatchydc.com/news/nation-world/national/article212491199.html>; More news coverage is compiled at: <http://www.borrowersbillofrights.org/media.html>

<sup>20</sup> Lipman and Wiersch (2019)

<sup>21</sup> See, for example, the merchant cash advance members of the ILPA, which includes APR in its existing SMART Box disclosure, available here: <https://innovativelending.org/smart-box-model-disclosure-depth/>

<sup>22</sup> Page 13, Department of Business Financial Protection, “Re: Small Business Disclosures, FILE NO: PRO 01-18,” Jan 2019. <https://dbo.ca.gov/wp-content/uploads/sites/296/2019/04/PRO-01-18-RBLC.pdf>

- Telephone Consumer Protection Act (TCPA),
- CAN-SPAM Act,
- Servicemembers Civil Relief Act (SCRA),
- Uniform Commercial Code (UCC),
- Treasury OFAC and Fincen regulations, and a range of other state or federal laws and regulations.

Assessing disclosures for compliance with SB 1235 will simply become a part of this work. Based on the experience of coalition members' compliance teams with the federal Truth in Lending Act in consumer lending, we believe the required ongoing compliance work would be less than the work of one full-time-equivalent compliance member, and thus likely not require hiring additional staff to a compliance function that is already fully staffed. Similarly, the work to create or amend a disclosure would fall within existing responsibilities of legal, compliance, product, and engineering professionals.<sup>23</sup>

We estimate that the cost to providers of coming into compliance with the proposed regulations for the first time, if not fully absorbed into the responsibilities of existing staff, could require the following:

<u>Form of Cost</u>	<u>FTE</u>	<u>Estimated Annual pay</u>	<u>Cost</u>
Compliance staff, to assess proposed disclosure revisions	15%	\$150,000	\$22,500
Product staff, to scope and design disclosure updates	10%	\$175,000	\$17,500
Engineering, if presenting financing offers online	0-10%	\$225,000	\$0 - \$22,500
Total			\$0 - \$62,500

Our review of the market suggests that about 166 providers may be covered by SB 1235, suggesting total compliance costs of less than \$10.4 million in the initial year, and significantly lower in subsequent years. This is far below the estimated savings to small businesses of \$1.4 billion to \$12.1 billion.

For sales-based financing providers, a decision to use the Underwriting Method of calculating sales projections for the estimation of payment amount, term, and APR would require some additional staff time for reporting data to the Department, which we believe is absolutely crucial for the success of SB 1235. (See Recommendation #1, below.) However, the Underwriting Method is entirely optional, to be used by providers who see that option as a business advantage.

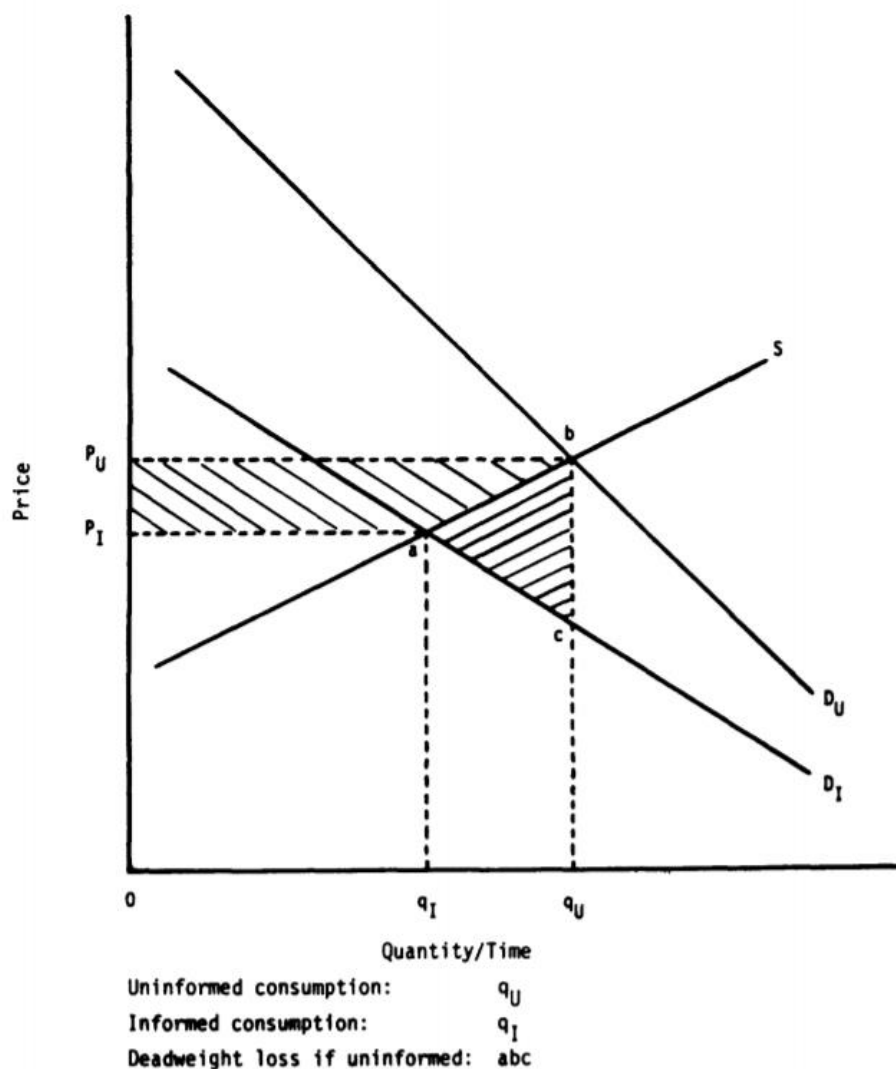
Make no mistake, the primary cost these rules introduce to financing companies is not compliance cost, but the cost of facing healthy price competition. When the lack of transparency is dispelled and comparison shopping is enabled, some small businesses will elect to seek lower-priced financing. Every dollar lost to higher-cost financing companies for this reason is a dollar saved by small businesses.

<sup>23</sup> These costs, and other economic impacts of implementing SB 1235, are discussed in more detail in the RBLC's January 2020 comment letter to the DBO, available here:

[http://www.borrowersbillofrights.org/uploads/1/0/0/4/100447618/rblc\\_comment\\_-\\_commercial\\_financing\\_disclosures\\_pro\\_01-18.pdf](http://www.borrowersbillofrights.org/uploads/1/0/0/4/100447618/rblc_comment_-_commercial_financing_disclosures_pro_01-18.pdf)

This exploitation of price asymmetry is described in economic literature as causing “deadweight loss” in the market. The lack of price transparency has the effect of transferring economic surplus from customers to providers. The market cannot reach an efficient equilibrium of price and quantity - resulting in economic waste, called deadweight loss.

The graph below visualizes this economic losses to small businesses today, depicted in the shaded regions.<sup>24</sup> Put simply, the market is operating inefficiently, and society is paying the price.



*Fig. 1. Consumer surplus loss from uninformed demand.*

<sup>24</sup> Vining, A., and Weimer, D, “Information Asymmetry Favoring Sellers: A Policy Framework.” Policy Sciences, 21(4), 281-303. 1998. Point “a” indicates the intersection of supply and demand, at a lower price point (“ $P_I$ ”), that would result from informed borrower choice. Point “b” represents the intersection of supply and demand today, where borrowers are paying higher price because of their lack of information (“ $P_U$ ”). The shaded region between them measures the deadweight loss.



One implication of this economic literature is that market forces are unlikely to solve this problem on their own. Financing companies are able to sell more product, and at a higher price, when they have an information advantage over their customers. It is not in providers' interests to solve this problem. Moreover, less-transparent companies have an advantage over more transparent companies. Less-transparent companies are able to extract higher prices from the customer, and apply this surplus to marketing to out-compete more-transparent companies, such as by paying higher fees to brokers or bidding up the price of online advertisements. This would keep prices inefficiently high and thwart innovation, if not for the well-considered, bipartisan action of the California legislature, and of the Department.

Savings derived from eliminating information asymmetry will mean the difference between life and death for some California businesses. Research by Opportunity Fund found small business customers of high-rate online loans in California making payments that averaged 178% of the business's available net income. The average loan in this set cost almost double what the small business could afford, pushing them into unprofitability. This rule will help some of them find another option, and survive.

Financing companies offering what Federal Reserve research describes as "higher-cost and less-transparent credit products"<sup>25</sup> may argue that the cost of complying will be passed on to their small business customers. This argument would posit that the small business financing market is highly competitive, with price competition fierce enough that financing companies across the market must lower their prices as much as they are able to attract customers. In a market this efficient, additional compliance costs would force a financing company out of business if those costs could not be passed on to the customer.

In fact, SB 1235 is needed in large part because the small business financing market is not efficient today, as described above. This is evident not only in economic theory, but also in market data. The undisclosed APRs charged by some small business financing companies average 94% in some categories, reaching 350% or more.<sup>26</sup> These prices do not reflect a finely-tuned, market equilibrium cost of doing business, but are often composed of arbitrary, unnecessarily high fees extracted through a lack of transparency. For example, an analysis of small business financing terms conducted by the Woodstock Institute found merchant cash advance companies charging fees such as:

- An \$399 "ACH fee," which bears no resemblance to the low cost of conducting payments through ACH. The RLBC has seen so-called "ACH fees" as high as \$1,995.
- A \$195 "UCC fee," while the cost of filing a UCC lien in Illinois, where the small business borrower was located, is \$20.<sup>27</sup>

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<sup>25</sup> Zeeuw (2019)

<sup>26</sup> St. Louis, Weaver, Donaker Brown, and McShane, Opportunity Fund, "Unaffordable and Unsustainable: The New Business Lending on Main Street," May 2016. [https://www.opportunityfund.org/wpcontent/uploads/2019/09/Unaffordable-and-Unsustainable-The-New-Business-Lending-on-Main-Street\\_Opportunity-Fund-Research-Report\\_May-2016.pdf](https://www.opportunityfund.org/wpcontent/uploads/2019/09/Unaffordable-and-Unsustainable-The-New-Business-Lending-on-Main-Street_Opportunity-Fund-Research-Report_May-2016.pdf)

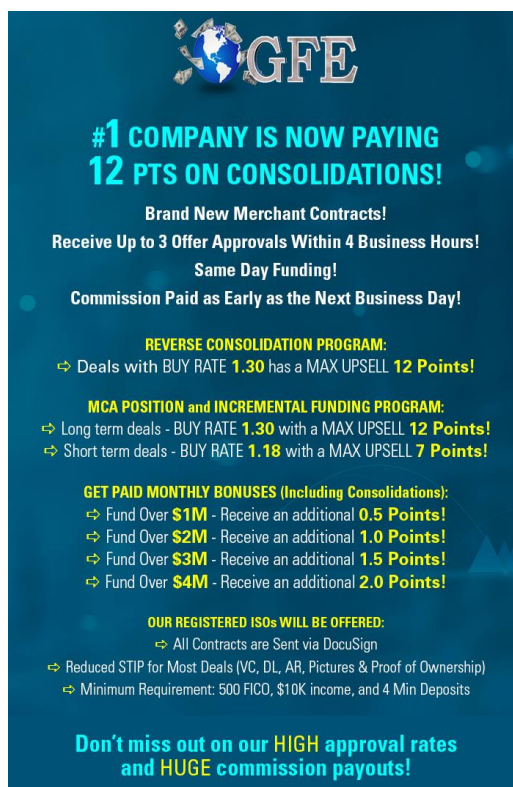
<sup>27</sup> See: UCC filing fee schedule published by the Illinois Secretary of State, available here: [https://www.cyberdriveillinois.com/publications/business\\_services/ucc.html](https://www.cyberdriveillinois.com/publications/business_services/ucc.html)

- A \$249 “risk assessment fee” in addition to a \$395 “origination fee.” It is not clear what cost was incurred by the financing company, and what service rendered to the small businesses, in exchange for the first fee but not the second.<sup>28</sup>

One troubled business shared with the RLBC a contract whose fine print included an “account management fee” which permitted the merchant cash advance company to double-charge the borrower one extra payment per month without applying that payment towards the amount the small business owed.<sup>29</sup> Another contract charged a 10% “due diligence fee,” and \$495 origination fee *in addition* to a 50% financing fee.

These fees do not characterize an efficient market, trimmed of fat, with profits earned through innovation and delivery of value. Instead, they demonstrate an ability to price arbitrarily, suggesting lack of price competition. APR provides a solution by combining the costs of fees like these into a single, annualized metric that can be used for apples-to-apples price comparison.

The role of marketing costs in small business financing provides further evidence that prices are not always driven by operational costs, such as compliance costs. Some financing seek to attract customers, not by providing the best prices permitted by their cost structure, but by charging prices high enough to pay brokers “HUGE commission payouts!” to quote an October 2020 advertisement included below.



**GFE**

**#1 COMPANY IS NOW PAYING  
12 PTS ON CONSOLIDATIONS!**

**Brand New Merchant Contracts!**  
**Receive Up to 3 Offer Approvals Within 4 Business Hours!**  
**Same Day Funding!**  
**Commission Paid as Early as the Next Business Day!**

**REVERSE CONSOLIDATION PROGRAM:**  
 ⇨ Deals with BUY RATE **1.30** has a MAX UPSSELL **12 Points!**

**MCA POSITION and INCREMENTAL FUNDING PROGRAM:**  
 ⇨ Long term deals - BUY RATE **1.30** with a MAX UPSSELL **12 Points!**  
 ⇨ Short term deals - BUY RATE **1.18** with a MAX UPSSELL **7 Points!**

**GET PAID MONTHLY BONUSES (Including Consolidations):**  
 ⇨ Fund Over **\$1M** - Receive an additional **0.5 Points!**  
 ⇨ Fund Over **\$2M** - Receive an additional **1.0 Points!**  
 ⇨ Fund Over **\$3M** - Receive an additional **1.5 Points!**  
 ⇨ Fund Over **\$4M** - Receive an additional **2.0 Points!**

**OUR REGISTERED ISOs WILL BE OFFERED:**  
 ⇨ All Contracts are Sent via DocuSign  
 ⇨ Reduced STIP for Most Deals (VC, DL, AR, Pictures & Proof of Ownership)  
 ⇨ Minimum Requirement: 500 FICO, \$10K income, and 4 Min Deposits

**Don't miss out on our HIGH approval rates  
and HUGE commission payouts!**

<sup>28</sup> Woodstock Institute, “Analysis of Business Loan Terms,” July 2016. “[https://woodstockinst.org/wp-content/uploads/2016/07/Woodstock\\_Analysis\\_of\\_Online\\_SB\\_Loan\\_Terms.pdf](https://woodstockinst.org/wp-content/uploads/2016/07/Woodstock_Analysis_of_Online_SB_Loan_Terms.pdf)”

<sup>29</sup> That contract read: “Account Management Fee - At the end of each month, Merchant will pay to ROYAL BUSINESS GROUP LCC an Account Management Fee. This fee will not be applied towards the reduction of the Purchased Amount. This monthly fee will equal the average of all the payments received as a “Specified Percentage” of the Merchants settle amount for that Month.” Without this fee, the APR appears to be 490%. With this fee, it appears to compute to 542%.

In this advertisement, the financing company offers brokers “12 PTS ON CONSOLIDATIONS!” which raises the question of how this financing consolidation could save a small business customer money if accompanied by a 12% fee. (These encouragements to refinance while paying high fees also recalls the “equity-stripping” practices of pre-2008 subprime mortgage markets.)

The advertisement goes on to offer brokers “MAX UPSELL 12 Points!” In other words, the broker is permitted to “upsell” the borrower, adding as high a fee as they are able to convince the borrower to pay, up to 12%, without telling the borrower they have added this fee. The fee has no relationship to the borrowers’ creditworthiness. This same practice in subprime mortgage lending, there called “yield-spread premiums,” has been cited as a cause of fraud and racial discrimination in the subprime mortgage lending market, and has been subject to Congressional limits and regulatory sanction.<sup>30</sup>

Text accompanying this advertisement further explains, “You heard it right... 12 POINTS! ... but why stop there? ... if you want to also earn up to 2 additional points based on your total monthly funding amount (including Consolidations), then start working your way up our MONTHLY VOLUME BONUS structure to maximize your earning potential.”

Making explicit that this is an effort to avoid competition in a manner that raises prices, instead of beating competition by lowering prices, the accompanying text continues: **“With a deal this good, why would you even consider submitting your deals elsewhere?”**

Regulation should not protect the anti-competitive behavior of financing companies shielding themselves from price competition by obscuring their high prices. If modified as recommended below, these rules will represent market-informed regulation that facilitates healthy price competition to lower the cost of capital for small businesses.

## Recommended Changes to the Proposed Draft Regulation

There are a number of opportunities for the proposed rules to be improved. Indeed, without certain improvements, the rules will not effectively establish the needed transparency. We believe that if the following recommendations are adopted, the Department's rules will protect California small businesses and model effective truth-in-lending regulation for the other states, and the federal government, that are looking to California now.

These recommendations are also reflected in the markup of the proposed rules text attached as Appendix B. That markup includes several additional clarifying suggestions not discussed within the body of this comment.

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<sup>30</sup> See, e.g. Consumer Financial Protection Bureau, “CFPB and Department of Justice Take Action Against Provident Funding Associates for Discriminatory Mortgage Pricing: Harmed African-American and Hispanic Borrowers Will Receive \$9 Million,” MAY 28, 2015. <https://www.consumerfinance.gov/about-us/newsroom/cfpb-and-department-of-justice-take-action-against-provident-funding-associates-for-discriminatory-mortgage-pricing/>

## I. Prevent merchant cash advances from low-balling their payment amounts and APRs

The proposed rules must be slightly modified to ensure that merchant cash advance companies' *flexibility* in disclosure estimations is paired with sufficient *accountability*. Under the currently proposed rules, merchant cash advance providers could disclose unreasonably low payment amounts and APRs, misleading small businesses without concern for consequence. AB 1864, which passed since these rules were drafted, provides the Department newly defined authority to address this problem.

As you know, the calculations of estimated payment amount, term, and APR for merchant cash advances are calculated based on a projection of the small business borrower's future sales. The proposed rule section §2091 wisely establishes two methods by which these projections can be determined for disclosure calculation purposes. The default is the highly-proscriptive "historical method," which is structured to avoid being "gamed" by financing companies that would seek to underestimate their APRs.

An additional, flexible "Underwriting Method" option is offered to enable providers to establish these projections though their own discretion. This Underwriting Method is a valuable alternative to the historical method for financing providers sophisticated enough to reflect sales trends, seasonality, or expected future sales events in their projections. The Underwriting Method should be maintained in the rules and should not be removed.

However, as currently written, the flexibility of the Underwriting Method is not paired with sufficient accountability to prevent its abuse. The Underwriting Method was originally proposed by the RBLC to include reporting to the Department to establish accountability. As currently written, providers using the Underwriting Method would instead conduct their own internal assessment of whether their disclosures have been sufficiently accurate. This creates two problems:

- A) There is little or no accountability - The Department will have no way of knowing whether the required internal assessment has taken place. If the internal assessment is conducted, and finds that a merchant cash advance company's payment amount and APR disclosures are unacceptably low, the Department will have no way of knowing whether the required changes are made to improve the disclosure. These companies will be well aware that the Department is the dark. Relying on self-policing by an industry regularly compared to pre-crisis subprime mortgage lending<sup>31</sup> is insufficient.
- B) The Department will be unable to learn and improve the rules - The rules establish accuracy tolerances of 10% and 5% for use of the Underwriting Method. It is not yet known whether these tolerance thresholds are too restrictive or too permissive. Without reporting, the Department may never know, and will be unable to make informed regulatory decisions to adjust these thresholds.

Both problems would be solved by requiring financing companies choosing to use the flexible "Underwriting Method" to report data to the Department. We urge the Department to consider requiring reporting in light of a few developments since this rule was drafted:

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<sup>31</sup> See, e.g. Shin, Laura, Forbes, "Why Online Small Business Loans are Being Compared to Subprime Mortgages," Dec 2015. <https://www.forbes.com/sites/laurashin/2015/12/10/why-online-small-business-loans-are-being-compared-to-subprime-mortgages/#1afdbb592889>

- 1) AB-1864 has granted the Department explicit new authority for rulemaking to require reporting on commercial financing activities. Section 90009(e) of that law reads:

“The department, by regulation, may define unfair, deceptive, and abusive acts and practices in connection with the offering or provision of commercial financing, as defined in subdivision (d) of Section 22800, or other offering or provision of financial products and services to small business recipients, nonprofits, and family farms. **The rulemaking may also include data collection and reporting on the provision of commercial financing or other financial products and services.**”<sup>32</sup>

If the Department was previously concerned that it lacked the authority under SB 1235 alone to require this reporting, even as a condition of utilizing an optional provision, clear statutory authority has now been granted.

- 2) Reporting this data is required under New York’s *Small Business Truth in Lending Act*, S5470/A10118, passed by the New York legislature in June. Like California’s SB 1235, these bills were passed in overwhelming, bipartisan votes. Financing companies already preparing to report this data to the New York Department of Financial Services would not be unduly burdened by submitting equivalent data to the California Department of Financial Protection and Innovation as well. These rules already require those companies to gather and analyze the data, so it should be readily available to send to the Department.

By adopting a similar reporting requirement consistent with California law, the Department would also aid interstate harmonization of small business financing disclosure regulation, and set an example that New York state can consider following in its rulemaking. Specifically, New York’s S5470 reads:

“§ 803(c)(II) THE PROVIDER USING THE OPT-IN METHOD SHALL DETERMINE THE ESTIMATED ANNUAL PERCENTAGE RATE, THE ESTIMATED TERM, AND THE PROJECTED PAYMENTS, USING A PROJECTED SALES VOLUME THAT THE PROVIDER ELECTS FOR EACH DISCLOSURE, PROVIDED, THAT THEY PARTICIPATE IN A REVIEW PROCESS PRESCRIBED BY THE SUPERINTENDENT. A PROVIDER SHALL, ON AN ANNUAL BASIS, REPORT DATA TO THE SUPERINTENDENT OF ESTIMATED ANNUAL PERCENTAGE RATES DISCLOSED TO THE RECIPIENT AND ACTUAL RETROSPECTIVE ANNUAL PERCENTAGE RATES OF COMPLETED TRANSACTIONS. THE REPORT SHALL CONTAIN SUCH INFORMATION AS THE SUPERINTENDENT, BY RULE OR REGULATION, MAY PRESCRIBE AS NECESSARY OR APPROPRIATE FOR THE PURPOSE OF MAKING A DETERMINATION OF WHETHER THE DEVIATION BETWEEN THE ESTIMATED ANNUAL PERCENTAGE RATE AND

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<sup>32</sup> California Legislative Information, “AB-1864 Financial institutions: regulation: Department of Financial Protection and Innovation,” Sept 2020. [http://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill\\_id=201920200AB1864](http://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201920200AB1864)



ACTUAL RETROSPECTIVE ANNUAL PERCENTAGE RATES OF COMPLETED TRANSACTIONS WAS REASONABLE.”<sup>33</sup>

- 3) Market monitoring has been reinforced as part of the Department’s expanded mandate. Collecting this data is consonant with this new mandate. Accepting this data need not represent a significant staffing cost to the Department. The existing reporting channels used for CFL reporting could be used for ease of administration. This data reporting would be limited to the firms that choose to opt-in to the voluntary, flexible Underwriting Method, and the Department can determine the frequency and extent to which it reviews that data submitted participants.

Here is an example of hypothetical report we recommend the Department require providers to submit, reflecting one line per financing account:

	A	B	C	D	E	F	G
1	Account Identifier	Financing Amount	Projected Total Monthly Payments	Actual Avg Total Monthly Payments	Estimated APR	Retrospective APR	APR Spread
2	123456	20,000	2,000	2,400	35%	42%	18%
3	123457	25,000	3,000	2,550	33%	28%	-14%
4	123458	15,000	1,000	1,050	39%	41%	5%
5	123459	40,000	5,000	4,750	24%	23%	-5%
6	123460	23,000	1,750	2,188	21%	26%	23%
7	123461	30,000	3,000	4,500	35%	51%	45%
8	123462	30,000	2,800	1,400	18%	9%	-48%
9	123463	30,000	2,500	3,500	40%	55%	37%
10	123464	30,000	5,000	10,000	46%	83%	79%
11	123465	8,000	3,000	900	31%	11%	-63%
12	123466	8,000	600	618	36%	37%	3%
13	123467	40,000	5,000	22,500	4%	13%	226%
14	123468	40,000	25,000	26,000	400%	412%	3%
15							
16	Audited APR Spread						5%

To implement this recommendation, we encourage the Department to include the following language in section 2092 “Estimates - Sales-based financing (accounts receivable purchase transactions) - Underwriting Method”

“(1) A provider that elects to make disclosures based upon internal estimated sales projections in accordance with this section shall annually report to the Department the following information for each financing account repaid within the previous 12 months:

- (A) A unique identifier for each financing account. Can be anonymized.
- (B) Financing amount.
- (C) The projected total payments per month disclosed to the recipient.

<sup>33</sup> The New York State Senate (2020)  
[https://nyassembly.gov/leg/?default\\_fld=&leg\\_video=&bn=S05470&term=2019&Summary=Y&Actions=Y&Text=Y](https://nyassembly.gov/leg/?default_fld=&leg_video=&bn=S05470&term=2019&Summary=Y&Actions=Y&Text=Y)

- (D) The average monthly payment amount made by the recipient, excepting any lump sum payment is used to pay off the financing faster than required by the contract.
- (E) The estimated APR disclosed to the recipient.
- (F) The retrospective APR that is calculated upon repayment by the recipient, as described in § 2092(4)(B).
- (G) The APR spread, as described in § 2092(4)(C).
- (H) The aggregate audited APR spread, as described in § 2092(4)(D) for each audit within the reporting period.

(2) Information provided to the Department by a provider pursuant to this section shall be considered confidential and not subject to disclosure by the Department pursuant to the Public Records Act (Government Code Section 6250 et seq.).”

The RBLC also recommends a revision to the proposed calculation for the APR Spread. Rather than measuring the number of percentage *points* of difference between the disclosed and actual retrospective APR, it should measure the percent of difference. This revised calculation we suggest is used in the table above.

Consider the final two rows of the table above as examples. Row 13 is an account with a disclosed Estimated APR of 4%. If the retrospective APR came out to be 13%, this would represent a significant inaccuracy but would fall within the proposed 10 percentage point accuracy threshold. It is less important that the two are 9 percentage points apart, as it is that disclosure was inaccurate by a factor of 226%. In this case, the provider disclosed estimated monthly payments totaling \$5,000, and in fact the resulting monthly payments averaged \$22,500. It is too inaccurate.

In row 14, the provider disclosed an Estimated APR of 400%, and the retrospective APR was calculated to be 412%. This provider would have delivered a fairly accurate estimate of the very high price, though this would fall outside of the proposed 10 percentage point accuracy threshold. It seems less important that the difference is 12 percentage points, given that the disclosure was within 3% of the actual retrospective APR. The disclosed estimate of total monthly payments was \$25,000, and the actual monthly payments totaled \$26,000.

Acknowledging that modifying the proposed rules may slow its implementation, we submit that the need to prevent merchant cash advance companies from low-balling their payment amount and APR disclosures warrants this revision.

## II. Prohibit deceptive description of fees as “rates” or “interest”

Federal Reserve research has repeatedly established that some common pricing metrics used today are misleading. The Department should clarify that these misleading practices are not permitted.

The Federal Reserve research has established that certain metrics, such as “simple interest,” “fee rate,” and “factor rate” are misunderstood by borrowers to be the interest rate or APR, when in fact they are generally much lower numbers than the actual interest rate or APR. We have little doubt that these metrics are used to mislead small

businesses into believing that high-cost financing is less expensive than it truly is. A 2018 Federal Reserve study<sup>34</sup> describes the confusion:

- **Participants were confused by terminology used to describe all three products.** For Product A, “repayment percentage options” was a confusing term for some participants who thought this was an interest rate, rather than a share of sales. For Product B, participants most commonly conflated “simple interest” with the APR. In addition, the phrasing of the statement “this rate *excludes* any fees, *including* a one-time origination fee of 3%” (emphasis added) perplexed some participants. For Product C, the term “factor rate” was the main source of confusion for a majority of participants who stated they had not heard it before.

In short, small businesses often understood any number described in percentage terms to be the interest rate or APR.

A 2019 follow-up study by Federal Reserve researchers found that “non-standard terminology” used by some alternative lenders “proved challenging for focus group participants trying to compare online offerings with traditional credit products.”<sup>35</sup> The following table from that study illustrates the severity of this confusion. In the left column, the “non-standard terminology” is displayed. As you can see, it is markedly lower than the actual APR noted in the right column.

<b>Rate advertised on website</b>	<b>Product details</b>	<b>Estimated APR equivalent</b>
1.15 factor rate	<ul style="list-style-type: none"> <li>• Total repayment amount \$59,000</li> <li>• Fees: 2.5% set-up fee; \$50/month administrative fee</li> <li>• Term: none (assume repaid in six months)</li> <li>• Daily payments (assume steady payments five days/week)</li> </ul>	Approximately 70% APR
4% fee rate	<ul style="list-style-type: none"> <li>• Total repayment amount \$56,500</li> <li>• Fee rate: 4% (months 1–2), 1.25% (months 3–6)</li> <li>• Fees: none</li> <li>• Monthly payments</li> <li>• Term: six-month term</li> </ul>	Approximately 45% APR
9% simple interest	<ul style="list-style-type: none"> <li>• Total repayment amount \$54,500</li> <li>• Fees: 3% origination fee</li> <li>• Weekly payments</li> <li>• Term: six-month term</li> </ul>	Approximately 46% APR
Source: Authors' calculations, based on product descriptions on company websites.		

<sup>34</sup> Lipman and Wiersch (2018)

<sup>35</sup> Lipman and Wiersch (2019)

Each of these “non-standard” metrics in the left column is, in fact, the same metric by a different name. It is a financing charge as a fraction of the financing amount. A more common term for this metric is a “fee.”

The first example in the table above, the “1.15 factor rate,” is more commonly understood as a 15% fee. The second example, a “4% fee rate,” would be more commonly understood as a 4% fee charged monthly. The third example, “9% simple interest,” is a 9% fee. It bears little resemblance to the interest rate, which would be 34%. (Combining that 34% effective interest rate with the 3% origination fee produces the 46% APR).

The solution we propose is not banning these metrics outright. Rather, our recommendation is that the Department require that these metrics not be formatted in a deceptive way. This is the approach taken in New York’s *Small Business Truth in Lending Act*, S 5470, which states in § 810: “IF OTHER METRICS OF FINANCING COST ARE DISCLOSED OR USED IN THE APPLICATION PROCESS OF A COMMERCIAL FINANCING, THESE METRICS SHALL NOT BE PRESENTED AS A “RATE” IF THEY ARE NOT THE ANNUAL INTEREST RATE OR THE ANNUAL PERCENTAGE RATE. THE TERM “INTEREST”, WHEN USED TO DESCRIBE A PERCENTAGE RATE, SHALL ONLY BE USED TO DESCRIBE ANNUALIZED PERCENTAGE RATES, SUCH AS THE ANNUAL INTEREST RATE.”<sup>36</sup>

In other words, these metrics could be used if they are described as a “fee,” or even a “1.20x factor,” but not as a “rate” or percentage of interest. We suggest this same language be incorporated into these rules, perhaps within section 3000 on “Annualized Rate Disclosure.”

Adopting the same requirements that providers will abide by in the State of New York does not place additional burden on the provider, and it ensures California’s small businesses are no less protected than New York’s. Moreover, we believe this requirement is consistent with the Department’s powers under SB 1235 to define regulations in conjunction in the disclosure of annualized rates, and with the additional powers granted to the Department under AB 1864.

Alternately, the Department could address the misleading disclosure of fees as “non-standard” rates, as a deceptive practice, and pursue it through UDAAP enforcement. As you know, existing federal UDAAP regulation establishes that:

“A representation, omission, actor practice is deceptive when:

- (1) The representation, omission, act, or practice misleads or is likely to mislead the consumer;
- (2) The consumer’s interpretation of the representation, omission, act, or practice is reasonable under the circumstances; and
- (3) The misleading representation, omission, act, or practice is material.”<sup>37</sup>

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<sup>36</sup> The New York State Senate (2020)

<sup>37</sup> Consumer Financial Protection Bureau, “Unfair, Deceptive, or Abusive Acts or Practices,” Oct 2012.

[https://files.consumerfinance.gov/f/documents/102012\\_cfpb\\_unfair-deceptive-abusive-acts-practices-udaaps\\_procedures.pdf](https://files.consumerfinance.gov/f/documents/102012_cfpb_unfair-deceptive-abusive-acts-practices-udaaps_procedures.pdf);

Federal Trade Commission, “FRC Policy Statement on Deception,” Oct 1983.

[https://www.ftc.gov/system/files/documents/public\\_statements/410531/831014deceptionstmt.pdf](https://www.ftc.gov/system/files/documents/public_statements/410531/831014deceptionstmt.pdf)

It is clear that these “non-standard” descriptions of fees are, by these terms, deceptive.

Nonetheless, we encourage the Department to address this practice within this rulemaking, as enforcement litigation in this case may be a slower, less effective path to establish clarity for providers and consistent, responsible practices across the market for small businesses.

### III. Require APR alongside any other price metric outside of the full disclosure

We recommend that the Department require APR be disclosed alongside any other price metric that occurs outside of the full disclosure. This might occur after the specific offer is first presented, triggering the full disclosure, for example. A financing company quoting “1.15x factor” would include “1.15x factor, 70% APR.” This specific example, from the Federal Reserve research table above, illustrates just how divergent certain price metrics can be from the APR, and the value for the small business borrower of maintaining the visibility of the APR.

Model language appears in the New York *Small Business Truth in Lending Act*, which states in § 810 that: “WHEN A PROVIDER STATES A RATE OF FINANCE CHARGE OR A FINANCING AMOUNT TO A RECIPIENT DURING AN APPLICATION PROCESS FOR COMMERCIAL FINANCING, THE PROVIDER SHALL ALSO STATE THE RATE AS AN ‘ANNUAL PERCENTAGE RATE’, USING THAT TERM OR THE ABBREVIATION ‘APR’.”<sup>38</sup>

As described in previous recommendations, harmonization with this requirement supports ease of operation for providers active on a national basis. More importantly, it provides valuable transparency for California small businesses, consistent with the goals of SB 1235.

### IV. Accurately reflect finance charges assessed in a “renewal”

The Department has been given express authority under Section 22804 of the Financial Code to determine and specify how the annualized rate shall be calculated, and the type of fees and charges that shall be included in the annualized rate calculation. To correctly portray the true cost of financing, disclosures of both APR and amount of funds must include all costs associated with financing renewals. If the costs associated are not incorporated, the resulting disclosures may meaningfully misinform California small business owners as they consider their financing options.

Specifically, if the finance charge does not include charges by the provider incurred as a requirement of obtaining the financing, it is incomplete and does not reflect the cost of the financing.

As indicated in the brokering advertisement above, some small business financing companies pursue a strategy of encouraging borrowers to refinance while extracting high fees each time, somewhat like the “equity stripping” subprime mortgage lending practices prior to the Great Recession. The practice in small business lending is less

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<sup>38</sup> The New York State Senate (2020)



transparent, however, because the fees are disguised in widely-reviled practice called double dipping. Below we propose a simpler solution for the Department to consider than offered in past comment letters.

Double dipping occurs when a small business refinances or renews their financing with their current provider, and the proceeds from the new loan or advance is used to pay off the balance from the previous loan or advance, including any unpaid or un-accrued interest or fees. In this way, the provider charges the borrower the same fixed-fee twice for the balance that was outstanding. The fixed fee is charged once as the outstanding balance is paid off, and then a second time for the same capital in the renewal.

This can be difficult to follow, which is why many small business owners may not realize they are being double-charged. The following image from a merchant cash advance company that does employ the practice suggests how confusing the hidden charge can be.<sup>39</sup>



Fortunately, there is a straightforward way to accurately reflect the cost in the disclosure. The most accurate way to reflect the cost of charges that are required as a condition of the new financing is to include them in the finance charge of the new financing.

These costs of double dipping can be easily distinguished from standard financing practices, such as origination fees, by the combination of (a) the requirement that previous financing from the same provider must be paid down to obtain the new financing, (b) a “maximum non-interest finance charge,” as defined by the Department, of greater than zero, and (c) a lack of reduction in the finance charged assessed at prepayment commensurate with the portion of the financing that is not utilized by the borrower.

In this example below, the applicant has been required to prepay an existing loan, as a condition of obtaining new financing. The existing loan has *one third* of the total repayment amount outstanding. Thus, the charge that the

<sup>39</sup> The Business Backer, “Double Dipping,” 2014. <https://www.youtube.com/watch?v=k62kCK5tZwo>

small business is required to pay in the refinancing is *one third* of the maximum non-interest finance charge. This \$3,333 (row F) is a requirement of obtaining the new financing, and so should be included in the financing charge of the renewal--just like other charges that are also required such as an origination fees.

	Loan #1				
A	Financing Amount	50,000			
B	Factor Charged	0.20			
C	Finance Charge	10,000	A*B		
D	Total Repayment Amount	60,000	A+C		
E	Amount Due @ Prepayment	20,000	Based on time of prepayment		
F	Prepayment Charge	3,333	C*(E/D)		

In the second illustration below, the financing provider does not “double dip” the borrower. They refund the unpaid financing charge that is associated with the last 1/3 of the loan that the borrower will not actually use (row F). As a result, there is no prepayment charge (row G) to include in the finance charge.

	Loan #1 without double dipping				
A	Financing Amount	50,000			
B	Factor Charged	0.20			
C	Finance Charge	10,000	A*B		
D	Total Repayment Amount	60,000	A+C		
E	Amount Due @ Prepayment	20,000	Based on time of prepayment		
F	Amount forgiven at prepayment	3,333			
G	Prepayment Charge	0	C*(E/D) - F		

To reflect this in the rule, we recommend that finance charges, as described in 3010(a), include the following language: “For all commercial financing transactions requiring that the recipient to pay off the balance of existing financing outstanding from the same provider, any prepayment charge or penalty required to be paid on the existing financing. For financing for which the maximum non-interest finance charge is greater than zero, the prepayment charge is equal to the maximum non-interest finance charge multiplied by the required prepayment amount as a percentage of the total repayment amount, minus any portion of the total repayment amount forgiven by the provider at the time of prepayment.”

Alternately, the Department could address this unnecessary and misleading practice of “double dipping” through enforcement, as an unfair, deceptive, or abusive act or practice. The “three card monte” concealment of charges fits clearly within the definition of “abusive” that appears in the Dodd-Frank Act, referred to in section 90009(c)(3) of California AB 1864:

“An abusive act or practice:

- Materially interferes with the ability of a consumer to understand a term or condition of a consumer financial product or service or
- Takes unreasonable advantage of:

- A lack of understanding on the part of the consumer of the material risks, costs, or conditions of the product or service;
- The inability of the consumer to protect its interests in selecting or using a consumer financial product or service; or
- The reasonable reliance by the consumer on a covered person to act in the interests of the consumer.”<sup>40</sup>

This practice of double dipping could similarly be described as unfair or deceptive.

## Recommendations for Implementation Outside of Rule Drafting

### V. Address enforceability by proceeding quickly with commercial UDAAP rulemaking

Unfortunately, the specific segments of the small business financing market that Federal Reserve research describes as “potentially higher-cost and less-transparent credit products” are generally unlicensed. These are the segments of industry where this rule is needed most. If the Department were able to enforce compliance with these disclosure rules only on licensed providers, it would fail to bring transparency where it is needed.

To clarify the Department’s authority to enforce transparency standards on unlicensed providers of small business financing, we urge the Department to undertake the commercial financing rulemaking set out in AB 1864 section 90009(e), as soon as possible.

That provision enables the Department to “define unfair, deceptive, and abusive acts and practices in connection with the offering or provision of commercial financing, as defined in subdivision (d) of Section 22800, or other offering or provision of financial products and services to small business recipients, nonprofits, and family farms.”<sup>41</sup>

Certainly, not complying with the transparency standards required under the law and these rules would be considered an unfair, deceptive, or abusive act or practice.

Broadly, we suggest that the Department simply define “unfair, deceptive, and abusive acts and practices” with respect to commercial financing by the same reference that define these terms for consumer financing in California and Federal law and regulation, such as Section 17200 of the California Business and Professions Code, the Dodd-Frank Act, and by extension the Federal Trade Commission Act.<sup>42</sup>

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<sup>40</sup> Title X of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. Sec. 5481)

<sup>41</sup> See California AB 1864

<sup>42</sup> See, e.g. California Legislative Information, “Law section,” 1993.

[https://leginfo.ca.gov/faces/codes\\_displaySection.xhtml?sectionNum=17200.&lawCode=BPC](https://leginfo.ca.gov/faces/codes_displaySection.xhtml?sectionNum=17200.&lawCode=BPC); Consumer Financial Protection Bureau, “Unfair, Deceptive, or Abusive Acts or Practices,” October 2012.

[https://files.consumerfinance.gov/f/documents/102012\\_cfpb\\_unfair-deceptive-abusive-acts-practices-udaaps\\_procedures.pdf](https://files.consumerfinance.gov/f/documents/102012_cfpb_unfair-deceptive-abusive-acts-practices-udaaps_procedures.pdf)

## VI. Establish a public complaint portal to support compliance

In order to ensure that these disclosure requirements are implemented consistently and accurately across the industry, we encourage the Department to include small business financing in its complaint collection processes. Complaint collection will provide the Department with market information about the effectiveness of the rule, and concerns of parties who may have been harmed. It would also signal to small business owners that the Department actively seeks their input and takes their complaints seriously.

Publishing these complaints would enable community groups to monitor the content and frequency of the complaints, to better understand and act on patterns of misbehavior. This is particularly important because SB 1235 requires disclosure from a wide range of small business financing companies, but does not require unlicensed parties to obtain a license or be otherwise regulated by the Department.

Therefore, an online complaint database would facilitate small businesses and their advocates to more effectively pursue the private right of action granted through SB 1235, complementing the enforcement activities of the Department. The small business finance sector is closely watching how SB 1235 is implemented and enforced in California. At a minimum, we believe the Department should provide a quarterly public report as to the number and type of complaints by provider.

## VII. Publish APR calculation formulas used in common software

By publishing formulas that providers can use to calculate APR in common software, the Department can address the concerns of providers unfamiliar with rate calculations, and encourage more reliable disclosures for small business owners. This could also potentially reduce the support burden on the Department by providing clear guidance and reducing instances of regulatory violations.

Other regulators have offered calculation support tools for truth in lending disclosures. For example, Regulation Z refers to the Regulation Z Annual Percentage Rate Tables produced by the CFPB.<sup>43</sup> Similarly, the OCC has published APR calculation software for lenders to use, called the Annual Percentage Rate Calculation Program for Windows (APRWIN).<sup>44</sup>

As you know, Regulation Z explicitly endorses the use of calculator tools like this: “Creditors may use any other computation tool in determining the annual percentage rate if the rate so determined equals the rate determined in accordance with Appendix J to this part, within the degree of accuracy set forth in paragraph (a) of this section.”<sup>45</sup>

This explicit regulatory endorsement would apply not only to the OCC’s APRWIN, but also to Microsoft Excel, Google Sheets, or the online calculators produced by Nav, provided they produce an appropriately accurate APR.

We do not believe it is necessary for the Department to produce its own calculator software. The simplest, most helpful approach would be to simply publish a webpage including the following formulas, which can be used in

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<sup>43</sup> 12 C.F.R. § 1026.22(b)(1). <https://www.consumerfinance.gov/policy-compliance/rulemaking/regulations/1026/22/>

<sup>44</sup> Office of the Comptroller of the Currency, Annual Percentage Rate Calculation Program for Windows (APRWIN),” n.d. “<https://www.occ.treas.gov/tools-forms/tools/compliance-bsa/aprwin-software.html>.

<sup>45</sup> 12 C.F.R. § 1026.22(b)(2). <https://www.consumerfinance.gov/policy-compliance/rulemaking/regulations/1026/22/>

common software programs to calculator APR. The following functions in Microsoft Excel or Google Sheets can be used to calculate APR consistent with the Regulation Z formula:

**1. For financing products with equal payment amounts and equal payment periods** (e.g., for loans, sales-based financing with flat sales projections or using Historical Method, etc.):

*APR = RATE (Number of payments, payment amount as a negative number, disbursed amount after fees deducted) \* Number of payment periods in one year to annualize*

**2. For financing products with unequal payment amounts and equal payment periods** (e.g., sales-based financing with projected or retrospective sales volumes that vary over the payment period, and payments monthly, weekly, or every day of the week):

*APR = IRR (select a series of cells indicating the flow of money, with the disbursed amount in the first cell, followed by cells representing the total charges in each subsequent payment period) \* Number of payment periods in one year to annualize*

**3. For financing products with unequal payment periods** (e.g., With payments on weekdays only):

*APR = ((XIRR (select a series of cells in two columns with the first column indicating the flow of payments, with the the disbursed amount in the first cell, and the second column indicating the corresponding dates of of each disbursement or payment) +1)^(1/365)-1)\*365*

Mathematical demonstrations that these formulas conform with the APR formula in the Truth in Lending Act/Regulation Z can be found in Appendix A of the RBLC’s September 9, 2019 comment to the Department on an earlier draft of these commercial financing disclosure rules.<sup>46</sup>

Thank you for considering these comments and for the care the Department has taken in developing these rules. With the few changes discussed above, these rules will provide California small businesses the transparency they need when shopping for financing, saving businesses millions or billions of dollars as they begin to rebuild from the destruction of the COVID-19 pandemic.

Please do not hesitate to contact us with any questions at [info@borrowersbillofrights.org](mailto:info@borrowersbillofrights.org).

Sincerely,

1. The Responsible Business Lending Coalition

Members include: Accion Opportunity Fund, Community Investment Management, Funding Circle, LendingClub, Opportunity Finance Network, Small Business Majority, StreetShares, and the Aspen Institute

2. Access Plus Capital

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<sup>46</sup> Responsible Business Lending Coalition, “Re: Second invitation for comments on proposed rulemaking—commercial financing disclosures, FILE NO: PRO 01-18,” Sept 2019.  
[www.borrowersbillofrights.org/uploads/1/0/0/4/100447618/rblc\\_coalition\\_comment\\_on\\_ca\\_dbo\\_small\\_business\\_financing\\_disclosures\\_-\\_pro\\_01-18\\_-\\_sept\\_2019.pdf](http://www.borrowersbillofrights.org/uploads/1/0/0/4/100447618/rblc_coalition_comment_on_ca_dbo_small_business_financing_disclosures_-_pro_01-18_-_sept_2019.pdf)



3. Accion Opportunity Fund
4. Accion San Diego
5. AmPac Tri-State CDC
6. ANewAmerica
7. Arcata Economic Development Corporation (AEDC)
8. Asian Business Association
9. Asian Business Association of the Inland Empire
10. Asian Pacific Islander Small Business Program (APISBP)
11. Bankers Small Business CDC of California
12. Bethel LA Community Development Corporation
13. Black Business Association
14. Business Center for New Americans
15. C.O.O.K. Alliance
16. California Asian Chamber of Commerce
17. California Asset-Building Coalition
18. California Association for Micro Enterprise Development (CAMEO)
19. California Black Chamber of Commerce
20. California Capital Financial Development Corporation
21. California Hispanic Chambers of Commerce (CAHCC)
22. California Reinvestment Coalition (CRC)
23. California Small Business Development Center (SBDC) - Valley Community
24. CDC Small Business Finance
25. CNote
26. Colorado Lending Source
27. Common Capital
28. Community Housing Opportunities Corporation (CHOC)
29. Community Investment Management (CIM)
30. Community Vision
31. Consumer Advocacy and Protection Society at Berkeley Law
32. Consumer Federation of California
33. Core Performance
34. Crane Works
35. Economic Development & Financing Corp. (EDFC)
36. El Concilio of San Mateo County
37. El Parajo Community Development Corporation
38. Faith and Community Empowerment (FACE)
39. Fresno Area Hispanic Foundation
40. Funding Circle
41. Go Local Sonoma County
42. The Greenlining Institute
43. Halo Business Finance
44. Hispanic Chambers of Commerce of San Francisco (HCCSF)
45. Housing and Economic Rights Advocates (HERA)
46. ICA Fund Good Jobs
47. Inclusive Action for the City
48. Inland Empire Regional Chamber of Commerce
49. International Rescue Committee San Diego
50. Invest in Women Entrepreneurs Initiative
51. Jefferson Economic Development Institute (JEDI)

52. Latino Business Network & Allies
53. LendingClub
54. Lighter Capital
55. Main Street Launch
56. The Marketplace Lending Association  
Members include: LendingClub, Prosper, Funding Circle, Avant, Marlette Funding, Affirm, Common Bond, Upstart, Peer Street, Lending Point, College Ave, and SoFi
57. Mission Economic Development Agency (MEDA)
58. Montecito Bank & Trust
59. Mountain Biz Works
60. Multifunding
61. National Federation of Filipino American Associations (NaFFA)
62. Nav
63. North Bay Jobs with Justice
64. Northern California Small Business Development Corporation (Nor-Cal FDC)
65. Opening Doors
66. Pacific Asian Consortium in Employment (PACE)
67. Pacific Community Ventures (PCV)
68. Primestor Investments, LLC
69. Prospera Community Development
70. Public Law Center (PLC)
71. Renaissance Entrepreneurship Center
72. Sac Black Biz
73. Silver Lining
74. Small Business California
75. Small Business Majority
76. StreetShares
77. TELACU Education Foundation
78. The Woodstock Institute
79. Time for Change Foundation
80. Venturize
81. Vermont Slauson Economic Development Corporation (VSEDC)
82. Veteran Launch
83. Wadeco Business Center
84. Women's Economic Ventures (WEV)
85. Working Solutions
86. 3 Core

## Attachments

### Appendix A - Additional Q&A materials

In the course of supporting New York State and the US Congress in pursuing legislation inspired by California's SB 1235, the RBLC has encountered a number of arguments against small business truth-in-lending efforts, primarily from financing companies that charge high APRs and do not disclose those rates to their customers.

Below are some of the claims we have encountered against these efforts, with responses.

**Claim 1:** Studies have shown that APR is confusing.

**Fact:** The only studies we are aware of that have concluded that APR is not helpful to small businesses were sponsored by financing companies that charge high APRs and oppose disclosure of APR. In contrast, at least four research studies at the Federal Reserve[i] support the conclusions that (a) small businesses are being misled by market disclosure practices today, (b) APR would help, and (c) small businesses want APR.

The value of transparent APR disclosure in small business financing has also been raised by:

1. The National Consumer Law Center[ii]
2. Bloomberg News editorial board ("Protect Small Businesses from Predatory Lending... The best solution would be for Congress to pass a [truth-in-lending](#) law for small business, along the lines of the rules that already exist for consumer loans.")[iii]
3. Federal Reserve Board of Governors Community Advisory Council[iv]
4. Federal Reserve Governor Lael Brainard[v]
5. The Conference of State Bank Supervisors' Fintech Industry Advisory Panel
6. 110+ industry and nonprofit signatories and endorsers of the Responsible Business Lending Coalition's *Small Business Borrowers Bill of Rights*[vi]
7. A dozen member companies of the Innovative Lending Platform Association[vii]
8. The Bipartisan Policy Center[viii]
9. Former SBA Administrator Karen Mills[ix]
10. US Treasury officials[x]
11. New York Department of Financial Services[xi]
12. Numerous news articles (e.g. McClatchy, "Even Finance Whizzes Say It's Impossible to Compare Online Small Business Loan Options." June 2018)[xii]

**Claim 2:** The CFPB concluded that APR is not a helpful disclosure.

**Fact:** The CFPB website states that: "The APR, or annual percentage rate, is the standard way to compare how much loans cost. It lets you compare the cost of loan products on an 'apples-to-apples' basis." [xiii] In a section on how to compare the cost of different types of financing products, such as short-term payday loans to longer-term installment loans or credit cards, the CFPB writes: "Tip: Focus on APRs." [xiv]

**Claim 3:** The CFPB and Federal Reserve have published studies stating that APR is misleading, ineffective, or not used by consumers.

**Fact:** Authors of these specific studies, when asked about this characterization of their studies by critics of APR disclosure, responded that, while the quotes referenced do reference arguments made by the Board and CFPB, the manner in which the quotes are used leaves out important context. As one of the authors noted, “They seem to use these quotes to imply the APR is not useful at all. I don’t think that that is the case, or what the agencies argued.” In the first instance (credit cards) the Board was eliminating a proposed *additional* APR. In the second instance (home mortgage lending), the CFPB gave prominence to the interest rate, but will retain the APR in another location. Unlike in small business financing, in mortgage lending the interest rate and APR are generally very close—within 0.6% on to bankrate.com today.[xv] But small business owners are often shown no interest rate or APR at all, while they may be paying APRs averaging 94% and upwards of 350%.[xvi]

**Claim 4:** Portions of the rules would be preempted by the federal Truth in Lending Act (TILA).

**Fact:** The National Consumer Law Center, which literally “wrote the book”[xvii] on the Truth in Lending Act that many finance attorneys consult to interpret the law, responds that, “Since the Truth in Lending Act and Regulation Z don’t apply to business credit... the preemption rules just don’t come into play. The whole reason for your bill is that TILA doesn’t apply.”

**Claim 5:** The APR should not be disclosed if it must be estimated.

**Fact:** The rules require disclosure of an “estimated APR” in some cases. This is consistent with the goals of the federal Truth in Lending Act. Senator Proxmire, sponsor of the federal Truth in Lending Act, explained on the floor of the Senate in 1967 that in cases when an exact APR cannot be calculated, the Truth in Lending Act “makes it abundantly clear that lenders need only state an approximate annual rate and would not be held to absolute accuracy down to the last decimal point.”[xviii]

**Claim 6:** The definition of “provider” is too broad because it would apply to brokers as well as lenders.

**Fact:** A recent Federal Reserve study on the need for improved transparency in small business financing notes that, “...because brokers may refer borrowers to certain online lenders based on higher commissions rather than on product suitability, their role in online lending is controversial. Recent research suggests that the majority of small-business borrowers do not comparison-shop online when applying for a loan. The implication is that by relying on brokers instead of comparison-shopping, small businesses may not end up with the most appropriate, affordable product.”[xix]

**Claim 7:** Disclosing the total monthly payments that a small business would be charged would confuse them.

**Fact:** Today, small businesses must compare the affordability of financing options that describe their charges as “\$176 per weekday,” “12% of receivables,” and \$1,340 per month.” Including a uniform disclosure of the total monthly payment amounts will enable small businesses to make apples-to-apples comparisons to find the product best suited for them. This disclosure is already undertaken by the dozens of financing providers that are signatories the *Small Business Borrowers’ Bill of Rights*[xx] and is required as part of the SMART Box.[xxi]

**Claim 8:** These disclosures would treat loans and purchase transactions the same. Loans and purchases should not be treated the same.

**Fact:** The purchase products referenced here are merchant cash advances. The Bipartisan Policy Center, in a report co-chaired by former Republican Senator Olympia Snowe and Democratic SBA chief Karen Mills, explained that, “There can also be confusion around some forms of small business credit, called merchant cash advances. These products are not classified as loans and, as such, are not expressed in terms of an APR, making it challenging to compare with other types of credit products.”[xxii] The proposed rules solve this problem.

**Claim 9:** The practice of “double dipping” need not be addressed because it is not a problem.

**Fact:** Double dipping is described as an irresponsible practice, even among small business financing providers. See, for example, “Beware: Double Dipping!” by financing company Next.[xxiii]

**Claim 10:** Requiring disclosure of potential prepayment charges in dollars is unnecessary.

**Fact:** Federal Reserve research recently concluded that small businesses today are confused by the prepayment practices used by some financing companies, and that more transparent disclosures would help. “Without such information,” the study explains, “focus group participants often made the assumption that, as is the case with traditional credit products, they would save money by repaying faster. In fact, there is usually no savings associated with early repayment on these products.”[xxiv]

**Claim 12:** APR is inappropriate for financing shorter than a year.

**Fact:** It is impossible to accurately compare financing products without a standardized unit of time. In financing, that common unit of time is the year. Moreover, the business model of many short-term, sales-based financing providers is to encourage borrowers to renew their product multiple times, so that even short-term products are used for longer than one year anyway. As an example, one provider has advertised on their website: “Approximately 90% of our Merchant Cash Advance clients participate in the program more than once. In fact, the average customer renews about ten times!” [xxvi]



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[i] Lipman, Barbara and Wiersch, Anne Marie, Board of Governors of the Federal Reserve System, “Uncertain Terms: What Small Business Borrowers Find When Browsing Online Lender Websites,” Dec 2019.

<https://www.federalreserve.gov/publications/files/what-small-business-borrowers-find-when-browsing-online-lender-websites.pdf>;

Lipman and Wiersch, Federal Reserve Bank of Cleveland, “Alternative Lending through the eyes of ‘Mom & Pop’ Small-Business Owners,” August 2015. <https://www.clevelandfed.org/newsroom-and-events/publications/special-reports/sr-20150825-alternative-lending-through-the-eyes-of-mom-and-pop-small-business-owners.aspx>;

Lipman and Wiersch Federal Reserve Board of Governors, “Browsing to Borrow: ‘Mom & Pop’ Small Business Perspectives on Online Lenders,” June 2018. <https://www.federalreserve.gov/publications/files/2018-small-business-lending.pdf>;

Zeeuw, Mels de, Federal Reserve Bank of Atlanta, “Small Business Credit Survey: Report on Minority-Owned Firms,” Dec 2019. <https://www.fedsmallbusiness.org/medialibrary/fedsmallbusiness/files/2019/20191211-ced-minority-owned-firms-report.pdf> This study notes that “Minority-owned firms more frequently applied for potentially higher-cost and less-transparent credit products.”

[ii] See: Appendix B, Responsible Business Lending Coalition, “Re: Second invitation for comments on proposed rulemaking—commercial financing disclosures, FILE NO: PRO 01-18,” Sept 2019. [www.borrowersbillofrights.org/uploads/1/0/0/4/100447618/rblc\\_coalition\\_comment\\_on\\_ca\\_dbo\\_small\\_business\\_financing\\_disclosures\\_-\\_pro\\_01-18\\_-\\_sept\\_2019.pdf](http://www.borrowersbillofrights.org/uploads/1/0/0/4/100447618/rblc_coalition_comment_on_ca_dbo_small_business_financing_disclosures_-_pro_01-18_-_sept_2019.pdf)

[iii] Bloomberg Opinion Editorial Board, “Protect Small Businesses From Predatory Lending,” Nov 2018. <https://www.bloomberg.com/amp/opinion/articles/2018-11-28/confessions-of-judgment-small-business-and-predatory-lending>

[iv] See: page 7, Federal Reserve, “CAC Meeting Record 10/05/2018,” Oct 2018. <https://www.federalreserve.gov/aboutthefed/files/cac-20181005.pdf>

[v] Brainard, Lael, Board of Governors of the Federal Reserve System, “Remarks by Lael Brainard: Community Banks, Small Business Credit, and Online Lending,” 2015. <https://www.federalreserve.gov/newsevents/speech/brainard20150930a.pdf>

[vi] Borrower’s Bill of Rights, “Signatories,” <http://www.borrowersbillofrights.org/signatories.html>

[vii] Innovative Lending Platform Association, “Innovative Lending Platform Association,” <https://innovativelending.org/>

[viii] Greig, Mills, Snowe, and Walsh, Bipartisan Policy Center, “Main Street Matters: Ideas for Improving Small Business Financing,” Aug 2018. <https://bipartisanpolicy.org/report/main-street-matters-ideas-for-improving-small-business-financing/>

[ix] Mills, Karen and McCarthy, Brayden, Harvard Business School, “The State of Small Business Lending: Innovation and Technology and the Implications for Regulation,” 2016. [http://www.hbs.edu/faculty/Publication%20Files/17-042\\_30393d52-3c61-41cb-a78a-ebbe3e040e55.pdf](http://www.hbs.edu/faculty/Publication%20Files/17-042_30393d52-3c61-41cb-a78a-ebbe3e040e55.pdf)

[x] U.S. Department of Treasury, “Opportunities and Challenges in Online Marketplace Lending,” May 2016. <https://www.treasury.gov/connect/blog/Pages/Opportunities-and-Challenges-in-Online-Marketplace-Lending.aspx>;

Milano, Jessica, Progressive Policy Institute, “Shining a Light on Small Business Credit: Promoting a Transparent Marketplace,” Nov 2017. [https://www.progressivepolicy.org/wp-content/uploads/2017/11/PPI\\_SmallBizCredit\\_2017.pdf](https://www.progressivepolicy.org/wp-content/uploads/2017/11/PPI_SmallBizCredit_2017.pdf),

- [xi] Vullo, Maria, New York State Department of Financial Services, “NYDFS: Online Lending Report,” July 11 2018. [https://www.dfs.ny.gov/docs/reportpub/online\\_lending\\_survey\\_rpt\\_07112018.pdf](https://www.dfs.ny.gov/docs/reportpub/online_lending_survey_rpt_07112018.pdf)
- [xii] See e.g. Wieder, Ben, McClatchy, “Even Finance Whizzes Say It’s Impossible to Compare Online Small Business Loan Options.” June 2018. <https://www.mcclatchydc.com/news/nation-world/national/article212491199.html>; More news coverage is compiled at: <http://www.borrowersbillofrights.org/media.html>
- [xiii] Consumer Financial Protection Bureau, “Credit cards key terms,” [www.consumerfinance.gov/consumer-tools/credit-cards/answers/key-terms/](http://www.consumerfinance.gov/consumer-tools/credit-cards/answers/key-terms/)
- [xiv] Consumer Financial Protection Bureau, “My payday lender said my loan would cost 15 percent but my loan documents say the annual percentage rate (APR) is almost 400 percent. What is an APR on a payday loan and how should I use it?,” May 2017. [www.consumerfinance.gov/ask-cfpb/my-payday-lender-said-my-loan-would-cost-15-percent-but-my-loan-documents-say-the-annual-percentage-rate-apr-is-almost-400-percent-what-is-an-apr-on-a-payday-loan-and-how-should-i-use-it-en-1625/](http://www.consumerfinance.gov/ask-cfpb/my-payday-lender-said-my-loan-would-cost-15-percent-but-my-loan-documents-say-the-annual-percentage-rate-apr-is-almost-400-percent-what-is-an-apr-on-a-payday-loan-and-how-should-i-use-it-en-1625/)
- [xv] Bankrate, “Current Mortgage and Refinance Rates for Oct 2020,” Oct 2020. <https://www.bankrate.com/mortgage>
- [xvi] St. Louis, Weaver, Donaker Brown, and McShane, Opportunity Fund, “Unaffordable and Unsustainable: The New Business Lending on Main Street,” May 2016. [https://www.opportunityfund.org/wpcontent/uploads/2019/09/Unaffordable-and-Unsustainable-The-New-Business-Lending-on-Main-Street\\_Opportunity-Fund-Research-Report\\_May-2016.pdf](https://www.opportunityfund.org/wpcontent/uploads/2019/09/Unaffordable-and-Unsustainable-The-New-Business-Lending-on-Main-Street_Opportunity-Fund-Research-Report_May-2016.pdf)
- [xvii] National Consumer Law Center Digital Library, “TILA: One of the most powerful statutes at a consumer attorney's disposal,” <https://library.nclc.org/til>
- [xviii] Senator Proxmire, William, “Congressional Record - Senate,” Jan 1967. <https://web.archive.org/web/20120415005111/http://www.llsdc.org/attachments/wysiwyg/544/TILA-LH-CR-1967-01-31.pdf>
- [xix] Federal Reserve Bank of Cleveland, “Click, Submit: New Insights on Online Lender Applicants from the Small Business Credit Survey,” Oct 2016. <https://www.clevelandfed.org/newsroom-and-events/publications/special-reports/sr-20161012-click-submit.aspx>
- [xx] Responsible Business Lending Coalition, “RESPONSIBLE BUSINESS LENDING COALITION,” <http://www.borrowersbillofrights.org/>
- [xxi] Innovative Lending Platform Association, “SMART Box - ILPA,” <https://innovativelending.org/smart-box/>
- [xxii] Bipartisan Policy Center (2018)
- [xxiii] See, e.g. Next-Financing, “MCA Double Dipping,” <https://next-financing.com/double-dipping/>; Breakout Capital, “Double Dipping: Explained,” <https://www.breakoutfinance.com/double-dipping-explained/>
- [xxiv] Lipman and Wiersch (2019) Federal Reserve Board of Governors, “Uncertain Terms: What Small Business Borrowers Find When Browsing Online Lender Websites,” Dec 2019. <https://www.federalreserve.gov/publications/files/what-small-business-borrowers-find-when-browsing-online-lender-websites.pdf>
- [xxv] 12 C.F.R. § 1026.22(b)(1). <https://www.consumerfinance.gov/policy-compliance/rulemaking/regulations/1026/22/>
- [xxvi] MainStream Merchant Services, “MainStream Merchant Funding Programs.” <http://www.mainstreamms.com/solutions/merchant-funding-solutions/>

## Appendix B – Redline markup of the rules text

The markup below proposes language to implements the four recommendations above, and includes several other suggested clarifications not discussed in the body of the comment.

STATE OF CALIFORNIA  
DEPARTMENT OF BUSINESS OVERSIGHT  
CALIFORNIA CODE OF REGULATIONS  
TITLE 10, CHAPTER 3

The Department of Business Oversight hereby adopts the following new provisions to be added to Title 10, Chapter 3 of the California Code of Regulations:

### § 2057. Definitions.

(a) The following terms used in these rules shall have the following meanings:

- (1) “Approved advance limit” means the maximum advance that a financier is required to pay a recipient for the purchase of outstanding, unpaid legally enforceable claims under a factoring agreement. If a factoring agreement requires the financier to pay different maximum advances for different types of legally enforceable claims, and advances with respect to one type of legally enforceable claim do not reduce the maximum advances for other types of legally enforceable claims under the agreement, the approved advance limit means the sum of the different maximum advances for different types of legally enforceable claims.
- (2) “Approved credit limit” means the maximum advance that a financier is required to pay a recipient under a commercial open-ended credit plan agreement or asset-based lending transaction agreement. Where the commercial open-ended credit plan agreement or asset-based lending transaction agreement requires the financier to pay different maximum advances for different categories of advance (such as advances secured by inventory, accounts receivable, or others), and advances with respect to one category of advance do not reduce the maximum advance for another category of advance, the approved credit limit means the sum of the different maximum advances for different types of legally enforceable claims.
- (3) “Asset-based lending transaction” as set forth in section 22800, subdivision (c) of the Code only includes transactions that are loans under California law.
  - (A) “Forwarding payments,” as it pertains to the definition of “Asset-based lending transaction” set forth in section 22800, subdivision (c) of the Code, includes arrangements in which a recipient and the financier create an account in which third party obligors deposit payments, arrangements in which a recipient repays advances with the proceeds the recipient collects from the sale or disposition of goods or services financed with such advances, and arrangements in which the recipient directs third party obligors to make payments directly to the financier.
- (4) “At the time of extending a specific commercial financing offer” under section 22802 of the Code means:
  - (A) The time when a specific amount, rate or price, in connection with a

commercial financing, is quoted to a recipient, based upon information from, or about, the recipient; and

- (B) Any subsequent time when the terms of an existing commercial financing contract are amended or supplemented, prior to the recipient agreeing to the changes, if the resulting changes to the contract would result in an increase to the finance charge, payments, term, or annual percentage rate, regardless of whether those terms were previously disclosed to the recipient.
- (5) "Benchmark rate" means a rate index (such as the London Interbank Offered Rate (LIBOR), Prime Rate, WSJ Prime Rate, 1, 3, or 5 year Treasury Constant Maturity, etc.), based upon general market conditions, that is commonly used to calculate the interest rate in adjustable-rate transactions in the credit industry.
- (6) "Broker" means any person other than a financier who communicates a financing amount, rate or price relating to a commercial financing to a recipient based upon information from, or about, the recipient.
- (7) "Code" means the California Financial Code.
- (8) "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), and is repaid:
  - (A) in regular predetermined payments of a specified amount over a fixed period of time; or
  - (B) in the case of sales-based financing, in payments calculated as a percentage of sales or income but with a minimum requirement payment or payments such that the recipient is eventually required to repay the amount advanced regardless of the sales or income the recipient collects.
- (9) "Draw period" means the length of time during which a recipient may make draws under an open-ended credit plan or general factoring or asset-based lending agreement.
- (10) "Finance charge" means the amount of any and all costs of the financing, represented as a dollar amount, as more specifically described in section 3010 of these rules.
- (11) "Financier" means the person who provides or will provide the commercial financing to the recipient or any nondepository institution which enters into a written agreement with a depository institution to arrange for the extension of commercial financing by the depository institution to a recipient via an online lending platform administered by the nondepository institution.
- (12) "Initial interest rate" means, in a credit transaction with an interest rate that changes over time and cannot be calculated in advance for the entire term of the transaction, the rate that would be in effect at the time a disclosure is made, assuming the recipient accepted the financing offer.
- (13) "Interest rate" means the periodic rate at which interest accrues on the outstanding principal balance and (if interest is compounded) on accrued but unpaid interest in a commercial financing.
- (14) "Irregular payment" means any payment made to the financier that is not a periodic payment.
- (15) "Margin" means, in a commercial financing with an adjustable interest rate, the adjustment amount added to or subtracted from the benchmark rate used to calculate the interest rate.
- (16) "Maximum non-interest finance charge" means:

- (A) For all commercial financing except factoring, the maximum amount of the finance charge other than interest accrued that a recipient may be required to pay if the recipient chooses to prepay the outstanding balance due under a commercial financing agreement.
  - (B) For factoring, the maximum amount of the finance charge, other than interest accrued since the time the financier purchased the legally enforceable claim, that the recipient may be required to pay if the recipient repurchases the account receivable before the account receivable is due for payment by the account debtor.
- (17) "Particular payment channel or mechanism" means, with respect to sales-based financing, the payment channel(s) or mechanism(s) that will be used to determine the amount of a recipient's payment or a true-up. This may include, for example, income flowing through a deposit account or accounts, or payments received through a recipient's payment processor.
- (18) "Periodic payment" means any payment made to the financier at regular intervals.
- (19) "Provider" means the definition set forth in section 22800, subdivision (m) of the Code with the following clarifications:
- (A) A provider includes a financier when the financier communicates a specific amount, rate or price, in connection with a commercial financing, based upon information from, or about, a recipient, either directly to a recipient, or to a broker with the expectation that the information will be shared with a recipient.
  - (B) The phrase "administered by" excludes arrangements where a nondepository institution provides technology or support services for a depository institution's commercial financing program, provided that the nondepository institution has no interest, or arrangement or agreement to purchase any interest in the commercial financing extended by the depository institution in connection with such program, and the commercial financing program is not branded with a trademark owned by the nondepository institution.
- (20) The phrase "person who is presented with a specific commercial financing offer" in the definition of "Recipient" set forth under section 22800, subdivision (n), means the expected primary borrowers on a commercial loan, open-ended credit plan, or asset-based lending transaction, sellers in accounts receivable purchase transactions (including factoring), and lessees in lease financing transactions.
- (21) "Retrospective annualized rate" is the actual annualized rate, determined after the specific financing contract has been fully repaid to the financier, when the dates and amounts of all payments and fees are known.
- (22) "Sales-based financing" means a commercial financing transaction that is repaid by a recipient to the financier as a percentage of sales or income, in which the payment amount increases and decreases according to the volume of sales made or income received by the recipient. Sales-based financing also includes commercial financing transactions with a true-up mechanism.
- (23) "Specified payment amount" means the periodic pre-set amount stated in the contract described in subdivision (a)(28)(A) of this section.

(24) "Split rate" means, with respect to sales-based financing, the percentage used by the financier to calculate the payment amounts to be paid to the financier or true-ups.

(25) "Term" means, with respect to:

- (A) Factoring disclosures made pursuant to section 22802, subdivision (b)(3), the length of time between when the recipient receives payment from the financier for the legally enforceable claim and the date the legally enforceable claim becomes due and payable.
- (B) Factoring disclosures made pursuant to section 22803, subdivision (a)(3), the maximum length of time between when a financier will accept a legally enforceable claim and when that legally enforceable claim will become due and payable by the legally enforceable claim's account debtor.
- (C) With respect to closed-end transactions, commercial open-end credit plans, and asset-based lending transactions, the length of time that it is anticipated will be necessary for the recipient to fulfill its obligations under the financing agreement with respect to a particular loan advance; and
- (D) With respect to all other commercial financing, the length of time that it is anticipated will be necessary for the recipient to fulfill its obligations under a financing agreement;

subject, in each case, to the rules with respect to term specified in sections 2089 through 2092, 3001, and 3003, as applicable.

(26) "True-up" means any payment made to a recipient, any charge assessed to a recipient, and any adjustment to recipient's periodic payments pursuant to a true-up mechanism.

(27) "Reasonably anticipated true-up" means any true-up that the financing provider has a reasonable basis to expect will be made during the term of the contract, taking into account past performance of similar contracts (both those made to the recipient and other similar recipients) and the policies and procedures of the financier.

(28) "True-up mechanism" means, with respect to sales-based financing, a contractual arrangement with all the following elements:

- (A) The financier receives periodic payments based upon a pre-set amount (or amounts) stated in the contract;
- (B) The contract allows the recipient to request, or the financier to initiate, adjustments to the payment amount, credits to the recipient, or charges to the recipient after execution of the contract, so that the total amount paid by the recipient more closely reflects a split rate listed in the contract.

(29) With respect to factoring transactions:

- (A) "Account debtor" means the debtor with the primary obligation to pay the legally enforceable claim assigned by the recipient.
- (B) "Purchase price" means the amount that the financier agrees to pay the recipient for assignment of a legally enforceable claim.
- (C) "Factoring fee" means any fee charged by the financier to process the transaction plus the difference between the face value of a legally enforceable claim and the purchase price that the financier agrees to pay the recipient for assignment of that legally enforceable claim.

- (D) "Original advance amount" means the amount that a financier issues to a recipient upon receipt of a legally enforceable claim for payment.
- (E) "Reserve amount" means, in a reserve factoring transaction, the difference between the purchase price for a legally enforceable claim and the original advance amount, that is held in reserve to secure the financier in the event of non-payment of the legally enforceable claim, or to secure the financier in the event of nonpayment of other legally enforceable claims assigned or to be assigned by the recipient to the financier.
- (F) "Reserve factoring transaction" means a factoring transaction where, upon receipt of a legally enforceable claim for payment, a financier pays an original advance amount to the recipient that is less than the purchase price and holds the difference between the original advance amount and the purchase price to secure the financier against deficiencies on amounts paid by the account debtor on the legally enforceable claim or other legally enforceable claims assigned or to be assigned by the recipient to the financier.

(b) Unless otherwise stated, all references to "average" refer to "mean".

(c) All terms used in these rules which are defined in Division 9.5, section 22800 of the Code but not defined in these rules shall have the meanings ascribed to them in Division 9.5, section 22800 of the Code.

Note: Authority cited: Section 22804, Financial Code. Reference: Sections 22800, 22801, 22802, 22803 and 22804, Financial Code.

**§ 2060. General Formatting and Content Requirements.**

(a) Disclosures provided in accordance with sections 22800 through 22804 of the Code shall comply with the following requirements:

- (1) At the top of the disclosure, centered on the page or other display medium, the provider shall print the following statement in bold font: "OFFER SUMMARY."
- (2) At the bottom of the disclosure, below any other information required by this Article, the provider shall print the following statement: "California law requires this information to be provided to you to help you make an informed decision. By signing below, you are confirming that you received this information." Below the statement, the provider shall include a space for the recipient to sign the form labeled "Recipient Signature" and a space for the recipient to write the date of their signature, labeled "Date."
- (3) The term or estimated term of a transaction shall be disclosed in units of years and months, with any remaining days expressed as a portion of a month to the nearest two decimal points.
- (4) For the purposes of these disclosures, a provider shall 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".
- (5) The annual percentage rate shall be expressed to the nearest ten basis points.
- (6) The disclosures shall be presented to the recipient as a separate document from any other contract, agreement, or other disclosure document provided to the recipient, but may be mailed or transmitted in a package that contains other documents.



- (7) The provider may present the required disclosure in colors and typefaces that are clear, complete, conspicuous, easy to compare with other disclosures, and consistent with the requirements of this Chapter. A provider shall not use colors and typefaces that make any enumerated terms required by section 22802, subdivision (b) of the Code more clear or conspicuous than any other term required by that subdivision.
- (8) If the information in this section is provided to a recipient electronically, the provider shall include a method for the recipient to submit an electronic signature and automatic date stamp to comply with subdivision (a)(2) of this section and provide the recipient with the ability to receive a copy of the disclosure in a format that the recipient may keep. A format the recipient may keep includes hard copy disclosures, and electronic documents containing the required disclosures that the customer can save indefinitely for future reference.
- (9) Except with respect to sales-based financing, if a provider must make estimates or assumptions to provide any disclosure required by this chapter, the provider shall:
- (A) Base those estimates or assumptions on the best information reasonably available to the provider at the time of the disclosure;
  - (B) State clearly that any disclosure based upon an estimate or assumption is an “Estimate” by adding the word “Estimate” to the descriptive language of any required disclosure under this chapter; and
  - (C) State clearly any assumptions or estimates used as the basis for the disclosure in any explanation or description associated with the disclosure.
- (10) When making the disclosures required by this Chapter, for transactions where the applicable interest rate adjusts over time and the interest rate applicable for the entire term of the transaction cannot be calculated in advance, the provider shall assume that the applicable interest rate is the initial interest rate for any period of time when the interest rate cannot be calculated in advance.

Note: Authority cited: Section 22804, Financial Code. Reference: Sections 22800, 22801, 22802, 22803 and 22804, Financial Code.

#### § 2061 Closed-End Transaction Formatting and Content Requirements.

(a) Disclosures for closed-end transactions provided in accordance with section 22802 of the Code shall comply with the following requirements unless the closed-end transaction meets the definition of sales-based financing:

- (1) The provider shall present the disclosures in a table consisting of seven rows and three columns.
- (2) The first row of the table shall include only the following information:
  - (A) In the first column, the following language: “Funding You Will Receive.”
  - (B) In the second column, the amount of funds that will be provided to the recipient, excluding any deductions retained by the providers of the financing described in the disclosure, such as origination charges and amounts used to pay off other outstanding financings from these providers.
  - (C) In the third column, a description of how the amount in the second column was calculated, including a disclosure of the amount owed and the amounts and descriptions of any deductions excluded from (2)(B) above.

**Commented [A1]:** This is intended to clarify that “funding you would receive” would include amounts paid directly to sellers of goods or services purchased with the financing (e.g. equipment), or to refinance a loan from an unrelated provider. A \$10k loan used 100% for refinancing a 3<sup>rd</sup> party loan is still \$10k, not \$0.

This change would need to be replicated in the sections describing other types of financing.

(3) The second row of the table shall include only the following information:

(A) In the first column:

- (i) If the contract provides for a fixed interest rate or rates that are predetermined by the contract, or no interest rate, the following language: "Annual Percentage Rate (APR)".
- (ii) If the contract provides for an adjustable interest rate or rates that are not predetermined by the contract, the following language: "Initial Annual Percentage Rate (APR)".

(B) In the second column, the annual percentage rate calculated in accordance with section 3001 of these rules.

(C) In the third column:

- (i) The following language, if the contract provides for a single, fixed interest rate:

"APR is the cost of your financing expressed as a yearly rate. APR includes the amount and timing of the funding you receive, interest and fees you pay and the payments you make.

Your APR is not an interest rate. Your interest rate is [interest rate]. Your APR may be higher than your interest rate because APR incorporates interest costs and other finance charges."

- (ii) The following language, if the contract provides for a multiple pre-determined interest rates that change over time:

"APR is the cost of your financing expressed as a yearly rate. APR includes the amount and timing of the funding you receive, interest and fees you pay and the payments you make.

Your APR is not an interest rate. Your initial interest rate is [initial interest rate]. Your APR may be higher than your interest rate because APR incorporates interest costs and other finance charges."

- (iii) The following language, if the contract provides for an adjustable interest rate or rates that are not predetermined by the contract.

"APR is the cost of your financing expressed as a yearly rate. APR includes the amount and timing of the funding you receive, interest and fees you pay and the payments you make.

~~(iv)~~ APR is not an interest rate. Your initial interest rate is [initial interest rate]. Although your interest rate will adjust over time, for the purposes of calculating this APR estimate, we have used the initial interest rate for future periods where the interest rate is not preset by the contract. Your APR may be higher than your interest rate because APR incorporates interest costs and other

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finance charges.”

- (iv) The following language, if no part of the finance charge is based upon interest accrued:

APR is the cost of your financing expressed as a yearly rate. APR includes the amount and timing of the funding you receive, fees you pay and the payments you make.

Your APR is not an interest rate, and your loan does not have an interest rate.”

- (4) The third row of the table shall include only the following information:

- (A) In the first column:

- (i) If the contract provides for a fixed interest rate or rates that are predetermined by the contract, or no part of the finance charge is based upon interest accrued, the following language: “Finance Charge”.
- (ii) If the contract provides for an adjustable interest rate or rates that are not predetermined by the contract, the following language: “Estimated Finance Charge”.

- (B) In the second column, the total finance charge, calculated in accordance with section 3010 of these rules.

- (C) In the third column:

- (i) The provider’s calculation of the finance charge, with the amount and description of each expense (such as interest and origination fee) included in the finance charge.
- (ii) If the contract provides for an adjustable interest rate or rates that are not predetermined by the contract, an explanation of how the initial interest rate was used to calculate interest charges and a notice that the actual finance charge may vary.

- (5) The fourth row of the table shall include only the following information:

- (A) In the first column:

- (i) If the periodic payments will not vary over the term of the transaction or the periodic payments during the term of the transaction will vary and it is possible to calculate the payment amounts in advance, the following language: “Payment”.
- (ii) If the periodic payment amounts will vary over the term of the transaction and it is not possible to calculate the payment amounts in advance (e.g. due to an adjustable interest rate using a benchmark rate and a margin), the following language: “Initial Payment”.

- (B) If periodic payments during the term of the transaction will not vary:

- (i) In the second column, the amount of each periodic payment followed by a forward slash (/) and the frequency of each periodic payment (month, day, etc.) followed by the date and amount of any irregular payments listed in chronological order.

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- (ii) In the third column, a short explanation of the payment frequency and any irregular payments. The provider may also include a short statement describing when each payment will become due.
- (C) If periodic payments during the term of the transaction vary and it is possible to calculate the payment amounts in advance, the second and third columns in the fourth row shall be combined and the provider shall list the periodic payment amounts with a description of when each amount will become due followed by the date and amount of any irregular payments in listed chronological order. For example:  
  
Months 1-12: \$600/month  
Months 13-24: \$1200/month  
  
Maintenance Fee Due 2/1/2021: \$500.  
Maintenance Fee Due 8/1/2022: \$300.  
  
Or  
  
Payments 1-23: \$600/month  
Payment 24: \$2000.  
  
Maintenance Fee Due 2/1/2021: \$500.  
Maintenance Fee Due 8/1/2022: \$300.
- (D) If periodic payments during the term of the transaction vary and it is not possible to calculate all payment amounts in advance:
  - (i) In the second column, the initial periodic payment amount followed by a forward slash (/) and the frequency of each periodic payment followed by the date plus followed by reasonably anticipated irregular payments listed in chronological order.
  - (ii) In the third column, a statement describing how the initial period payment amount was calculated and that the actual payment may change over time, and an explanation of any irregular payments. The provider may also include a statement describing when the payment will adjust and how it will be calculated.
- (6) The fifth row of the table shall include only the following information:
  - (A) In the first column, the following language: "Term".
  - (B) In the second column, the term of the transaction.
  - (C) In the third column, an explanation describing the term.
- (7) In the first column, the sixth and seventh rows shall be combined and shall include only the following language: "Prepayment."
- (8) In the sixth row, the second and third columns shall be combined and include only:
  - (A) If, at any time during the term of the transaction, prepayment of the outstanding balance due will require the recipient to pay charges other than interest accrued since the recipient's last payment, the following statement: "If you pay off the financing early

you will ~~still~~ need pay all or portion of the finance charge, up to \$[maximum non-interest finance charge].”

**Commented [A3]:** Recommending additional word for clarity to the applicant

(B) In all other cases, “If you pay off the financing early, you will not need to pay any portion of the finance charge other than interest accrued since your last payment.”

(9) In the seventh row, the second and third columns shall be combined and shall include only:

(A) If, at any time during the term of the transaction, prepayment of the outstanding balance due will require the recipient to pay additional fees and charges not included in the finance charge, the following statement: “If you pay off the financing early you must also pay the following additional fees ~~not already included in the finance charge.~~” followed by the amounts and descriptions of each additional fees and charges.

(B) In all other cases, the following statement: “If you pay off the financing early you will not pay additional ~~prepayment~~ fees ~~not already included in the finance charge.~~”

**Commented [A4]:** We suggest specifying “prepayment” fees to clarify that this would not include late fees, etc.

**Commented [A5]:** While recognizing that RBLC suggested this language, this clause seems confusing and could be removed to shorten.

(10) If the contract provides for periodic payments that are not monthly, the provider shall insert one additional row below the third row, and the additional row shall include only the following information:

(A) In the first column: “Average Monthly Cost”.

(B) In the second column, the average monthly cost that the recipient will pay over the term of the transaction.

(C) In the third column, language explaining that the recipient will not be required to make monthly payments and explaining how the provider has calculated the monthly cost.

(11) If the contract provides for multiple payment options, then the provider shall insert one additional row above the first row, and in that row, all three columns shall be combined, resulting in a single cell. In that cell, the provider shall include a statement explaining how the provider has based the disclosure on the minimum payment permitted under the contract.

Note: Authority cited: Section 22804, Financial Code. Reference: Sections 22800, 22802 and 22804, Financial Code.

#### § 2062. Commercial Open-End Credit Plan Disclosure Formatting.

(a) Disclosures for commercial open-end credit plans, provided in accordance with section 22802 of the Code, shall comply with the following requirements:

(1) The provider shall present the disclosures in a table consisting of nine rows and three columns.

(2) In the first row, the first, second and third columns shall be combined, and the resulting cell shall have only the following language, in italics:

(A) If the contract allows only for a single payment option: “The calculations below are based on an initial draw of your full Approved Credit Limit of [approved credit limit] and assume that you will pay off the draw entirely according to the agreed payment schedule, that you miss no payments, and that you do not re-draw on this line. Actual costs may differ substantially.”

- (B) If the contract allows for multiple payment options: "The calculations below are based on an initial draw of your full Approved Credit Limit of [approved credit limit] and assume that you will choose to make minimum payments, that you miss no payments, and that you do not re-draw on this line. Actual costs may differ substantially." If the amount borrowed is payable on demand, the provider shall disclose that amounts borrowed are payable on demand and that the estimate assumes a term of one year. If an alternate maturity date is stated in the legal obligation between the parties, then the provider shall state that the disclosure is based upon that maturity date.
- (3) The second row of the table shall include only the following information:
- (A) In the first column, the following language: "Funding You Will Receive".
  - (B) In the second column, the maximum credit amount, minus any deductions such as origination charges and amounts used to pay off other financings.
  - (C) In the third column, a description of how the amount in the second column was calculated, including a disclosure of the amount owed and the amounts and descriptions of any deductions excluded from (3)(B) above.
- (4) The third row of the table shall include the following information:
- (A) In the first column:
    - (i) If the contract provides for a fixed interest rate or rates that are predetermined by the contract, the following language: "Annual Percentage Rate (APR)".
    - (ii) If the contract provides for an adjustable interest rate and it is not possible to calculate the interest rates throughout the term of the transaction in advance, the following language: "Initial Annual Percentage Rate (APR)".
  - (B) In the second column, the provider's calculation of the annual percentage rate calculated in accordance with section 3001 of these rules.
  - (C) In the third column:
    - (i) If the contract provides for a single, fixed interest rate, the following language:

"APR is the cost of your financing expressed as a yearly rate. APR includes the amount and timing of the funding you receive, interest and fees you pay and the payments you make.

APR is not an interest rate. Your interest rate is [interest rate]. Your APR may be higher than your interest rate because APR incorporates interest costs and other finance charges."
    - (ii) If the contract provides for multiple pre-determined interest rates that change over time, the following language:

"APR is the cost of your financing expressed as a yearly rate. APR includes the amount and timing of the funding you receive, interest and fees you pay and the payments you make.

Your APR is not an interest rate. Your initial interest rate is [initial interest rate]. Your APR may be higher than your interest rate because APR incorporates interest costs and other finance charges."

(iii) If the contract provides for an adjustable interest rate and it is not possible to calculate the interest rates throughout the term of the transaction in advance, the following language:

"APR is the cost of your financing expressed as a yearly rate. APR includes the amount and timing of the funding you receive, interest and fees you pay and the payments you make.

APR is not an interest rate. Your initial interest rate is [initial interest rate]. Although your interest rate will adjust over time, for the purposes of calculating this APR estimate, we have used the initial interest rate for future periods where the interest rate is not preset by the contract. Your APR may be higher than your interest rate because APR incorporates interest costs and other finance charges."

- (5) The fourth row of the table shall include only the following information:
- (A) In the first column the following language: "Estimated Finance Charge".
  - (B) In the second column, the total finance charge calculated in accordance with section 3010 of these rules.
  - (C) In the third column, an explanation of the provider's calculation of the finance charge, with the amount and description (such as interest charges and origination fees) of each expense that is included in the finance charge. In addition, if the contract provides for an adjustable interest rate that changes over time, an explanation of how the initial interest rate was used to calculate interest charges.
- (6) The fifth row of the table shall include only the following information:
- (A) In the first column "Estimated Payment".
  - (B) If periodic payments during the term of the transaction will not vary:
    - (i) In the second column, the amount of each periodic payment followed by a forward slash (/) and the frequency of each periodic payment followed by the date and amount of any irregular payments listed in chronological order.
    - (ii) In the third column, a short explanation of the payment frequency and any irregular payments. The provider may also include a short statement describing when each payment will become due.



- (C) If periodic payments during the term of the transaction vary and it is possible to calculate the payment amounts in advance, the second and third columns in the fifth row shall be combined and the provider shall list the periodic payment amounts with a description of when each amount will become due followed by the date and amount of any irregular payments in listed chronological order and any assumptions made when calculating the payment amounts. For example:

Months 1-12: \$600/month

Months 13-24: \$1200/month

Maintenance Fee Due 2/1/2021: \$500.

Maintenance Fee Due 8/1/2022: \$300.

- (D) If periodic payments during the term of the transaction vary and it is not possible to calculate all payment amounts in advance because the transaction has an adjustable interest rate that cannot be calculated in advance:
- (i) In the second column, a periodic payment amount calculated using the initial interest rate followed by the date and amount of any reasonably anticipated irregular payments listed in chronological order.
  - (ii) In the third column, a statement explaining that the periodic payment amount disclosed is based upon the initial interest rate, and that the actual rate may change over time and an explanation of any irregular payments. The provider may also include a statement describing when the payment will adjust and how it will be calculated.
- (E) If periodic payments of principal during the term of the transaction do not vary but periodic payments of interest during the term of the transaction vary, and it is not possible to calculate all interest payment amounts in advance, because the transaction has an adjustable interest rate that cannot be calculated in advance:
- (i) In the second column, the phrase "Initial Interest Payment:" followed by an interest payment amount calculated using the initial interest rate, followed by a forward slash (/) and the frequency of each periodic interest payment.
  - (ii) In the second column, beneath the disclosure required by subdivision (6)(E)(i), the phrase "Principal Payment Amount:" followed by the amount of each periodic principal payment, followed by a forward slash (/) and the frequency of each periodic principal payment.
  - (iii) In the third column, a statement explaining that the Initial Interest Payment Amount disclosed is based upon the initial interest rate, and that the actual rate may change over time.
  - (iv) In the third column, beneath the statement explaining the Initial Interest Payment Amount and at the same height as the disclosure required under subdivision (6)(E)(iii), a short explanation of the principal payment amount and frequency.

- (7) The sixth row of the table shall include only the following information:

- (A) In the first column, the following language: "Draw Period."
  - (B) In the second column, the draw period for the transaction.
  - (C) In the third column, an explanation of the draw period for the transaction.
- (8) The seventh row of the table shall include only the following information:
- (A) In the first column, the following language: "Term."
  - (B) In the second column, the term of the transaction.
  - (C) In the third column, an explanation describing the term.
- (9) In the first column, the eighth and ninth rows shall be combined and shall include only the following language: "Prepayment."
- (10) In the eighth row, the second and third columns shall be combined and shall include only:
- (A) If, at any time during the term of the transaction, prepayment of the outstanding balance due will require the recipient to pay finance charges other than interest accrued since the recipient's last payment, the following statement: "If you pay off the financing early you will still need pay all or portion of the finance charge, up to \$[maximum non-interest finance charge]."
  - (B) In all other cases, "If you pay off the financing early, you will not need to pay any portion of the finance charge other than interest accrued since your last payment."
- (11) In the ninth row, the second and third columns shall be combined and shall include only:
- (A) If, at any time during the term of the transaction, prepayment of the outstanding balance due will require the recipient to pay additional fees and charges not included in the finance charge, the following statement: "If you pay off the financing early you must also pay additional fees ~~not already included in the finance charge~~" followed by the amounts and descriptions of the additional fees and charges.
  - (B) In all other cases, the following statement, "If you pay off the financing early you will not pay additional prepayment fees ~~not already included in the finance charge~~."
- (12) If the contract provides for periodic payments that are not monthly, the provider shall insert one additional row below the fourth row, and the additional row shall include only the following information:
- (A) In the first column, the following language: "Estimated Average Monthly Cost."
  - (B) In the second column, the average monthly cost that the recipient will pay over the term of the transaction.
  - (C) In the third column, language explaining that the recipient will not be required to make monthly payments and explaining how the provider has calculated the monthly cost.

Note: Authority cited: Section 22804, Financial Code. Reference: Sections 22800, 22802, 22803 and 22804, Financial Code.

**§ 2063. Factoring Disclosure Format**

- (a) Disclosures for factoring transactions provided in accordance with section 22802 of the Code shall comply with the following requirements:
- (1) The provider shall present the required disclosures in a table consisting of six rows and three columns.
  - (2) The first row of the table shall include only the following information:
    - (A) In the first column, the following language: "Funding You Will Receive."
    - (B) In the second column, the amount of funds that will be provided to the recipient, excluding any deductions such as origination charges and amounts used to pay off other financings, and excluding any reserve amount.
    - (C) In the third column, a description of how the amount in the second column was calculated, including any origination charges, amounts used to pay off other financings, and reserve amounts excluded from the amount disclosed in the second column. If the factoring transaction involves a reserve amount, a description of when the reserve amount will be paid to the recipient and any conditions imposed upon such delivery.
  - (3) The second row of the table shall include only the following information:
    - (A) In the first column, the following language: "Estimated Annual Percentage Rate (APR)".
    - (B) In the second column, the estimated annual percentage rate calculated in accordance with sections 3001 and 3002 of these rules.
    - (C) In the third column, the following language:
      - i. "APR is estimated cost of your financing expressed as a yearly rate. APR includes the amount and timing of the funding you receive, fees you pay, and payments made to [name of financier]."
      - ii. If no part of the finance charge is based upon an interest rate, the following language in addition to the language required by subdivision (3)(C)(i) of this section: "APR it is not an interest rate and the amount of the factoring fee we charge is not based upon an interest rate."
  - (4) The third row of the table shall include the following information:
    - (A) In the first column, the following language: "Finance Charge".
    - (B) In the second column, the total finance charge calculated in accordance with section 3010 of these rules.
    - (C) In the third column, the provider's calculation of the finance charge, with the amount and description of each expense that is included in the finance charge.
  - (5) The fourth row of the table shall include only the following information:
    - (A) In the first column, the following language: "Payment".
    - (B) In the second column, the following language: "NA" or "Not applicable".
    - (C) In the third column, a statement describing why the recipient is not ordinarily required to make payments under the contract. For example: "You are selling an invoice to us, so you will not be required to make any payments to us unless your

**Commented [A6]:** It is not clear that disclosure of a "payment" is needed for factoring products, as no payment is generally made by the small business. In a sense, the payment is made the borrowers client, when they pay the amount due on the factored invoice. RBLC recommends considering deletion of this row.

customer fails to pay the invoice and we find that you breached your warranty to us by failing to deliver the invoiced goods to your customer.”

(6) The fifth row of the table shall include only the following information:

- (A) In the first column, the following language: “Estimated Term”.
- (B) In the second column, the term of the transaction.
- (C) In the third column, a statement describing how the provider calculated the term. For example, “The invoice is due for payment 30 days from today, so we have estimated a term of 1 month. The invoice may be paid sooner than the due date.”

(7) The sixth row of the table shall include only the following information:

(A) In the first column, the following language: “~~prepayment~~.”

(B) The second and third columns shall be combined, and:

- (i) If the recipient is permitted to repurchase the legally enforceable claim for payment before the legally enforceable claim is due and payable, the resulting combined cell shall be divided vertically into two cells by a horizontal line, and:
  - (a) If at any time during the term of the transaction, repurchase of the legally enforceable claim will result in the recipient paying finance charges other than interest since the advance was made, the top cell shall include the following statement: “If you repurchase the [description of legally enforceable claim] before the due date you must pay all or a portion of the finance charge, which could be as high as \$[maximum non-interest finance charge].”
  - (b) In all other cases, the top cell shall include the following statement, “If you repurchase the [description of legally enforceable claim] before the due date you will not pay any portion of the finance charge other than interest earned since disbursement.”
  - (c) If, at any time during the term of the transaction, repurchase of the legally enforceable claim will require the recipient to pay additional fees and charges not included in the finance charge, the bottom cell shall include the following statement: “If you repurchase the [description of legally enforceable claim] before the due date, you must pay additional fees and charges that are not part of the finance charge, including [amount and description of fees].”
  - (d) In all other cases, the bottom cell shall state: “If you repurchase the [description of legally enforceable claim] before the due date, you will not be required to pay any additional fees and charges that are not already ~~included in part of~~ the finance charge.”
- (ii) If the recipient is not permitted to repurchase the legally enforceable claim for payment before the legally enforceable claim is due and payable, the resulting cell shall include the following statements:
  - (a) “You are not permitted to pay the amount due on the [description of legally enforceable claim] before your customer’s due date.”

**Commented [A7]:** It is not clear that disclosure of term is needed for factoring products, other than within the explanation the assumptions used to calculate the APR. i.e. “To calculate this APR, we have estimated that the invoice will be paid in 1 month.”  
RBLC recommends considering deletion of this row.

**Commented [A8]:** Perhaps this should be referred to as “Repurchase costs” and included only if there are such costs?  
The term “prepayment” may confuse recipients in the factoring context, who may anticipate making future payments.

- (b) If applicable: “The finance charge will not decrease if your customer pays the [description of legally enforceable claim] before the due date.”

Note: Authority cited: Section 22804, Financial Code. Reference: Sections 22800, 22802, 22803 and 22804, Financial Code.

#### § 2064. Factoring Disclosure Format for Example Transactions

- (a) Disclosures for factoring transactions provided in accordance with section 22803 of the Code shall comply with the following requirements:
- (1) The provider shall present the required disclosures in a table consisting of seven rows and three columns.
  - (2) All three columns of the first row of the table shall be combined, and within the cell created, the provider shall include only the following language, in italics:
    - (A) If the finance charge, annual percentage rate and term do not vary for different classes of legally enforceable claim: “The calculations below are based upon a hypothetical [description of legally enforceable claims to be assigned, e.g. “Invoice”] of [value calculated in accordance with section 3022 of these rules], assigned to [insert name of financier] with a due date [term] from the date of assignment. Actual costs may differ substantially.”
    - (B) If the finance charge, annual percentage rate or term will vary for different classes of legally enforceable claims with different characteristics, the following in the order listed:
      - (i) “The calculations below are based upon a hypothetical [description of legally enforceable claims to be assigned, e.g. “invoice”] of [insert value calculated in accordance with section 3022 of these rules], assigned to [name of financier] with a due date [term] from the date of assignment.”
      - (ii) A description of the class of the legally enforceable claim for which the disclosure applies. For example: “These calculations further assume that the account debtor on the invoice is [name of account debtor].”
      - (iii) “Actual costs may differ substantially.”
  - (3) The second row of the table shall include only the following information:
    - (A) In the first column, the following language: “Funding You Will Receive”.
    - (B) In the second column, the amount of funds that will be provided to the recipient, excluding any deductions such as origination charges and any reserve amount, for an example transaction compliant with section 3022 of these rules.
    - (C) In the third column, a description of how the amount in the second column was calculated, including the amount and description of any fees or reserve amounts deducted. If the factoring transaction involves a reserve amount, a description of when the reserve amount will be paid to the recipient and any conditions imposed upon such delivery.

**Commented [A9]:** RBLC suggests clarifying whether this section §2064 would this apply to a transaction where a specific, identified invoice is being factored. It seems that in that case, no additional example is required.

- (4) The third row of the table shall include only the following information:
- (A) In the first column, the following language: "Annual Percentage Rate (APR)."
  - (B) In the second column, the provider's calculation of the annual percentage rate of the transaction calculated in accordance with sections 3001 and 3002 of these rules.
  - (C) In third column, the following language:  
  
"This is the estimated cost of your financing expressed as a yearly rate. APR includes the amount and timing of the funding you receive, fees you pay, and payments made to [name of financier]. This estimate assumes that you will assign the [description of legally enforceable claim assigned, e.g. "invoice"] to [name of financier] today, the invoice is due in [term] and your customer will pay the [name of legally enforceable claim assigned, e.g. "invoice"] in full on the due date."
  - (D) If no part of the finance charge is based upon an interest rate, the following language in addition to the language required by subdivision (4)(C) of this section:  
"APR is not an interest rate and the amount of the finance charge is not based upon an interest rate."
- (5) The fourth row of the table shall include the following information:
- (A) In the first column, the following language: "Finance Charge."
  - (B) In the second column, the total finance charge calculated in accordance with section 3010 of these rules.
  - (C) In the third column, the provider's calculation of the finance charge, with the amount and a description of each expense (e.g. factoring fee, origination fee, etc.) that is included in the finance charge.
- (6) The fifth row of the table shall include only the following information:
- (A) In the first column, the following language: "Payment Amount".
  - (B) In second column, the following language: "NA" or "Not applicable."
  - (C) In the third column, a statement describing why the recipient is not ordinarily required to make payments under the contract. For example: "You are selling an invoice to us, so you will not be required to make any payments to us unless your customer fails to pay the invoice and we find that you breached your warranty to us by failing to deliver the invoiced goods to your customer.")
- (7) The sixth row of the table shall include only the following information:
- (A) In the first column, the following language: "Estimated Term."
  - (B) In the second column, the term of the transaction.
  - (C) In the third column, a statement describing how the provider calculated the term. For example: "You are permitted to assign us invoices that are due a maximum of 60 days from the invoice date, so we have estimated a term of 2 months. The invoice may be paid sooner than the due date."
- (8) The seventh row of the table shall include only the following information:
- (A) In the first column, the following language: "Prepayment."
  - (B) The second and third columns shall be combined, and:

- (C) If the recipient is permitted to repurchase the legally enforceable claim for payment before the legally enforceable claim is due and payable, the resulting combined cell shall be divided vertically into two cells by a horizontal line, and:
- (i) If at any time during the term of the transaction, repurchase of the legally enforceable claim will result in the recipient paying finance charges other than interest since the advance was made, the top cell shall include the following statement: "If you repurchase the [description of legally enforceable claim] before the due date, you must pay all or a portion of the finance charge, which could be as high as \$[maximum non-interest finance charge]."
  - (ii) In all other cases, the top cell shall include the following statement, "If you repurchase the [description of legally enforceable claim] before the due date, you will not pay any portion of the finance charge other than interest earned since disbursement."
  - (iii) If, at any time during the term of the transaction, repurchase of the legally enforceable claim will require the recipient to pay additional fees and charges not included in the finance charge, the bottom cell shall include the following statement: "If you repurchase the [description of legally enforceable claim] before the due date, you must pay additional fees and charges that are not part of the finance charge, including [amount and description of fees]."
  - (iv) In all other cases, the bottom cell shall state: "If you repurchase the [description of legally enforceable claim] before the due date, you will not be required to pay any additional fees and charges not already included in the finance charge."
- (D) If the recipient is not permitted to repurchase the legally enforceable claim for payment before the legally enforceable claim is due and payable, the resulting cell shall include the following statements:
- (i) "You are not permitted to pay the amount due on the [description of legally enforceable claim] before your customer's due date."
  - (ii) If applicable: "The finance charge will not decrease if your customer pays the [description of legally enforceable claim] before the due date."

Note: Authority cited: Section 22804, Financial Code. Reference: Sections 22800, 22802, 22803 and 22804, Financial Code.

#### **§ 2065. Sales-Based Financing Disclosure Formatting**

- (a) Disclosures for all sales-based financing provided in accordance with section 22802 of the Code, except for asset-based lending that meets the definition of sales-based financing, shall comply with the following requirements:
- (1) The provider shall present the required disclosures in a table consisting of eight rows and three columns.



- (2) The first row of the table shall include only the following information:
- (A) In the first column, the following language: "Funding You Will Receive"
  - (B) In the second column, the amount of funds that will be provided to the recipient, excluding any deductions such as origination charges and amounts used to payoff other financings.
  - (C) In the third column, a description of how the amount in the second column was calculated, including the amount and description of any deductions. For example: "This is your advance amount of [advance amount] minus the [amount and description of fees deducted] that will be deducted."
- (3) The second row of the table shall include only the following information:
- (A) In the first column, the following language: "Estimated Annual Percentage Rate (APR)."
  - (B) In the second column, the annual percentage rate calculated in accordance with section 3001 of these rules.
  - (C) In the third column, the following language:

"APR is the estimated cost of your financing expressed as a yearly rate. APR incorporates the amount and timing of the funding you receive, fees you pay, and the periodic payments you make. This calculation assumes your estimated monthly income through [description of particular payment channel or mechanism] will be average [monthly income estimate determined in accordance with sections 2091 or 2092 of these rules]."

- (D) If no part of the finance charge is based upon an interest rate, the following language in addition to the language required by subdivision (3)(C) of this section: "APR it is not an interest rate. The amount of the finance charge you will pay is not based upon an interest rate."

- (4) The third row of the table shall include only the following information:
- (A) In the first column, the following language: "~~Estimated~~ Finance Charge".
  - (B) In the second column, the finance charge calculated in accordance with section 3010 of these rules.
  - (C) In the third column, the provider's calculation of the finance charge, with the amount and description of each expense that is included in the finance charge. ~~In addition, if the finance charge will not increase under any circumstance if repayment takes longer than estimated, the provider may include the following statement: "Your finance charge will not increase if you take longer to pay off what you owe."~~

- (5) The fourth row of the table shall include only the following information:
- (A) In the first column, the following language: "Estimated Payment".
  - (B) The second and third columns shall be combined, and contain the following information:
    - (i) The amount of each estimated periodic payment calculated in accordance with section 3003 of these rules, followed by a forward slash (/) and the frequency of each periodic payment. If the provider anticipates that the periodic payment

**Commented [A10]:** Suggesting this change because, the projections of providers using the underwriting method may vary over the course of the term.

**Commented [A11]:** Sales-based is generally characterized by having fixed, not estimated, finance charges. The finance charge should not be described as "estimated."

**Commented [A12]:** This wording is confusing and unnecessary. What it describes is equally true for traditional closed-end loans, in that the full interest charge of the entire term is already included in the finance charge. Thus small businesses are unlikely to mistakenly believe that the finance charge could increase if they take longer to repay.

amount will vary over the term of the transaction, either due to changes in the recipient's income through the particular payment channel, a change in the split rate, or some other reason provided for in the contract, the provider shall list the estimated periodic payment amounts calculated in accordance with section 3003 of these rules, and the time periods when those estimates apply. For example:

Months 1-2:  
\$20/day

Months 3-7:  
\$40/day

- (ii) The date and amount of any irregular payments listed in chronological order.
- (iii) The date and amount of any reasonably anticipated true-ups.

(6) The fifth row of the table shall include only the following information:

- (A) In the first column, the following language: "Payment Terms."
- (B) The second and third columns shall be combined, and contain the following information:
  - (i) If the contract provides for daily periodic payments, a description of when daily payments will be required. For example, on weekdays or every calendar day.
  - (ii) If applicable, a plain language description of how the financier will use the split rate to calculate the recipient's required payments. For example: "Each business day, your credit card processor will remit 15% of your gross receipts to us, and send any remaining amounts to you."
  - (iii) If the contract contains a true-up mechanism,
    - (a) A statement explaining how the provider calculated the pre-set periodic payment(s) described in Section 2057, subdivision (a)(28)(A). For example: "We based your preset daily payment of \$75 upon our estimate of 15% of your total income, based upon average monthly income of \$15,000 for the last three months."
    - (b) A short, plain language description of the true-up mechanism, and a reference to the part of the contract that describes the terms of the true-up mechanism, if available. For example: "You have the right to receive refunds of all or part of your payments if you demonstrate that your payments have exceeded 15% of your total income during any given month. For more details on your rights, see paragraph 5 of your contract."
  - (iv) A plain language description of any minimum payment terms under the contract. For example: "You must pay us a minimum of \$2,000 per month under the contract."

(7) The sixth row of the table shall include only the following information:

- (A) In the first column, the following language: "Estimated Term".

- (B) In the second column, the estimated term of the transaction, calculated in accordance with section 3003 of these rules.
- (C) In the third column, an explanation stating that the estimated term is based upon assumptions about the recipient's income. For example:

"This is our estimate of how long it will take to collect amounts due to us under the contract based upon the assumption that you will receive \$6,000 in monthly income through your BrownPay account."

- (D) In the first column, the seventh and eighth rows shall be combined and shall include the following language: "Prepayment."
- (8) In the seventh row, the second and third columns shall be combined and shall include only:
- (A) If, at any time during the term of the transaction, prepayment of the outstanding balance due will require the recipient to pay finance charges other than interest accrued since the recipient's last payment, the following statement, "If you pay off the financing faster than required, you will still be required to pay all or a portion of the finance charge, up to \$[maximum non-interest finance charge] based upon our estimates."
  - (B) In all other cases, the following statement: "If you pay off the financing faster than required, you will not be required to pay any portion of the finance charge other than interest owed since your last payment."
- (9) In the eighth row, the second and third columns shall be combined and shall include:
- (A) If, at any time during the term of the transaction, prepayment of the outstanding balance due will require the recipient to pay additional fees and charges not included in the finance charge, the following statement: "If you pay off the financing faster than required, you must pay additional fees ~~not already included in the finance charge, including~~ of [amount and description of fees]."
  - (B) In all other cases, the following statement: "If you pay off the financing faster than required, you will not be required to pay additional prepayment fees ~~not already included in the finance charge.~~"
- (10) If the contract provides for periodic payments that are not monthly, the provider shall insert one additional row below the third row, and the additional row shall include only the following information:
- (A) In the first column, the following language: "Estimated Monthly Cost."
  - (B) In the second column, the estimated monthly cost that the recipient will pay over the term of the transaction calculated in accordance with section 3003 of these rules. If the provider anticipates that the estimated monthly cost will vary over the term of the transaction, either due to changes in the recipient's income through the particular payment channel, a change in the split rate, or some other reason provided for in the contract, the provider shall list the estimated monthly costs and the time periods when those estimates apply. For example:

Months 1-2:  
\$600/month

Months 3-6:  
\$1200/month

Month 7:  
\$1000/month

- (C) In the third column, a description of how the provider calculated the estimated monthly cost. For example: "Although you do not make payments on a monthly basis, this is our calculation of your average monthly cost based upon the payment amounts disclosed below."

Note: Authority cited: Section 22804, Financial Code. Reference: Sections 22800, 22802 and 22804, Financial Code.

**§ 2066. Formatting and Content Requirements for Lease Financing.**

- (a) Disclosures for lease financing provided in accordance with section 22802 of the Code shall comply with the following requirements:
- (1) The provider shall present the disclosures in a table consisting of seven rows and three columns.
- (2) The first row of the table shall include only the following information:
- (A) In the first column, the following language: "Funding Provided."
- (B) In the second column:
- (i) If the financier does not select, manufacture or supply the goods to be leased, the net cost to the financier to acquire the property to be leased;
- (ii) If the financier selects, manufactures or supplies the goods to be leased, the price that the financier would sell the goods for in a cash transaction, minus any down payment or other deposit to be paid by the recipient.
- (C) In the third column, a description of how the amount in the second column was calculated. For example: "This is the amount we will pay to the supplier to acquire the van that you will lease."
- (3) The second row of the table shall include only the following information:
- (A) In first column the following language: "Annual Percentage Rate (APR)".
- (B) In second column, the annual percentage rate calculated in accordance with section 3001 of these rules.
- (C) In the third column, the following language:

"APR is the cost of your financing expressed as a yearly rate. APR incorporates the amount and timing of the funding you receive, fees you pay, the periodic payments you make, and the anticipated cost for you to acquire the property at the end of the lease term.

Your APR is not an interest rate."

- (4) The third row of the table shall include only the following information:
- (A) In first column the following language: "Finance Charge".
  - (B) In second column, the total finance charge, calculated in accordance with section 3010 of these rules.
  - (C) In the third column, the provider's calculation of the finance charge, with the amount and description of each expense included in the finance charge.
- (5) The fourth row of the table shall include only the following information:
- (A) In the first column the following language: "Payment".
  - (B) If periodic payments during the term of the transaction will not vary:
    - (i) In the second column, the amount of each periodic payment followed by a forward slash (/) and the frequency of each periodic payment (month, day, etc.), followed by the date and amount of any irregular payments listed in chronological order, followed by the price of the purchase option.
    - (ii) In the third column, a short explanation of the payments, followed by an explanation of any irregular payments. For example: "This is how much you will pay each month, the \$300 maintenance fee due 12 months after you receive funding, and the purchase price you may pay at the end of the lease to acquire the property." The provider may also include a short statement describing when each payment will become due. For example: "Your monthly payments are due on the 1<sup>st</sup> day of every month."
  - (C) If periodic payments during the term of the transaction vary, the second and third column in the fourth row shall be combined and the provider shall list the periodic payment amounts with a description of when each amount will become due, followed by the date and amount of any irregular payments listed in chronological order, followed by the price of the purchase option. For example:

Months 1-12: \$600/month  
Months 13-24: \$1200/month

Maintenance Fee Due 2/1/2021: \$500.  
Maintenance Fee Due 8/1/2022: \$300.

Purchase Price: \$1000.

Or

Payments 1-23: \$600/month  
Payment 24: \$2000.

Maintenance Fee Due 2/1/2021: \$500.  
Maintenance Fee Due 8/1/2022: \$300.

Purchase Price: \$1000.

- (6) The fifth row of the table shall include only the following information:
- (A) In first column, the following language: "Term".
  - (B) In second column, the term of the transaction.
  - (C) In third column, an explanation describing the term. For example: "This is how long you will make lease payments under the contract."
- (7) In the first column, the sixth and seventh rows shall be combined and shall include the following language: "Prepayment."
- (8) In the sixth row, the second and third columns shall be combined and include only:
- (A) If, at any time during the term of the transaction, prepayment of the outstanding balance due will require the recipient to pay finance charges other than interest accrued since the recipient's last payment, the following statement: "If you pay off the financing before the end of the Term, you will be required to pay all or a portion of the finance other than interest since your last payment, up to \$[maximum non-interest finance charge]."
  - (B) In all other cases, the following statement: "If you pay off the financing before the end of the Term, you will not be required to pay any portion of the finance charge other than interest owed since your last payment."
- (9) In the seventh row, the second and third columns shall be combined and shall include only:
- (A) If, at any time during the term of the transaction, prepayment of the outstanding balance due will require the recipient to pay additional fees and charges not included in the finance charge, the following statement: "If you pay off the financing before the end of the term, you must pay additional fees or charges not included in the Finance Charge, including" followed by a description of any prepayment charges.
  - (B) In all other cases, the following statement: "If you pay off the financing before the end of the term, you will not be required to pay additional fees or charges not included in the Finance Charge."
- (10) If the contract provides for periodic payments that are not monthly, the provider shall insert one additional row below the third row, and the additional row shall include only the following information:
- (A) In the first column, the following language: "Average Monthly Cost."
  - (B) In the second column, the average monthly cost that the recipient will pay over the term of the transaction.
  - (C) In the third column, language explaining that the recipient will not be required to make monthly payments and explaining how the provider has calculated the monthly cost. For example: "Although you do not make payments on a monthly basis, this is our calculation of your average monthly cost based upon the payment amounts disclosed below."

**Commented [A13]:** Perhaps this clause should be not included, if there is no interest charged as part of the lease, as would be typical.

Note: Authority cited: Section 22804, Financial Code. Reference: Sections 22800, 22802 and 22804, Financial Code.

**§ 2067 General Asset-Based Lending Transaction Disclosure Formatting.**

- (a) Disclosures for asset-based lending transactions, provided in accordance with section 22803 of the Code and section 3021 of these rules, shall comply with the following formatting requirements, unless the asset-based lending transaction meets the definition of inventory financing:
- (1) The provider shall present the required disclosures in a table consisting of nine rows and three columns.
  - (2) All three columns of the first row of the table shall be combined, and within the cell created, the provider shall provide an explanation, in italics, of all assumptions used to calculate the disclosures, and a notice, if applicable, that actual costs may differ substantially from those disclosed. For example: "The calculations below are based upon a hypothetical lump sum draw of [amount calculated in accordance with Section 3021], with no additional draws, repaid from the collection of the accounts receivable or payment intangibles that secure this loan. We anticipate we will receive an average of [insert amount anticipated] per day in repayments from your customers' accounts. Actual costs may differ substantially."
  - (3) The second row of the table shall include only the following information:
    - (A) In the first column, the following language: "Funding You Will Receive."
    - (B) In the second column, the amount of funds calculated in accordance with Section 3021, excluding any deductions such as origination charges and amounts used to pay off other financings.
    - (C) In the third column, a description of how the amount in the second column was calculated, including the amount and description of any deductions. For example: "This is your advance amount of [advance amount] minus the [amount and description of fees deducted]."
  - (4) The third row of the table shall include only the following information:
    - (A) In the first column, the following language: "Estimate Annual Percentage Rate (APR)."
    - (B) In the second column, the annual percentage rate calculated in accordance with section 3001 of these rules.
    - (C) In the third column, the following language in the order listed:
      - (i) "APR is the estimated cost of your financing expressed as a yearly rate. APR incorporates the amount and timing of the funding you receive, fees you pay, and the payments we collect. APR is not an interest rate."
      - (ii) A description of the applicable interest rate or rates for the transaction, if applicable.
  - (5) The fourth row of the table shall include only the following information:
    - (A) In the first column, the following language: "Estimated Finance Charge".
    - (B) In the second column, the finance charge calculated in accordance with section 3010 of these rules.
    - (C) In the third column, the provider's calculation of the finance charge, with the amount and description of each expense that is included in the finance charge, and a statement that that the actual finance charge may vary, if applicable.



(6) The fifth row of the table shall include only the following information:

- (A) In the first column, the following language: "Payment"
- (B) In the second column, the amount of each periodic payment, followed by a forward slash (/) and the frequency of each periodic payment (month, day, etc.) followed by the date and amount of any irregular payments listed in chronological order. If the provider anticipates that the estimated monthly cost will vary over the term of the transaction, either due to changes in the recipient's income through the particular payment channel, or for some other reason provided for in the contract, the provider shall list the periodic payment amounts and the time periods when those estimates apply, followed by the date and amount of any irregular payments listed in chronological order. For example:

Months 1-2:  
\$20/day

Months 3-7:  
\$40/day

Month 6: \$100 maintenance fee.

- (C) In the third column, a statement describing how the lender will receive repayments and an explanation of any irregular payments. For example: "This is how much we anticipate collecting each day in repayments from your customers' accounts. You will also pay a \$300 maintenance fee 12 months after you receive funding."

(7) The sixth row of the table shall include only the following information:

- (A) In the first column, the following language: "Draw Period."
- (B) In the second column, the draw period for the transaction.
- (C) In the third column, an explanation of the draw period for the transaction.

(8) The seventh row of the table shall include only the following information:

- (A) In the first column, the following language: "Term."
- (B) In the second column, the term of the transaction.
- (C) In the third column, an explanation stating that the estimated term is based upon assumptions about the recipient's income. For example:

"Although your contract does not have a set term, this is our estimate of how long it will take to collect amounts due to us under the contract based upon the assumption that we will receive \$700 per day in repayments from your customers' accounts."

(9) In the first column, the eighth and ninth rows shall be combined and shall include the following language: "Prepayment."

(10) In the eighth row, the second and third columns shall be combined and shall include only:

- (A) If, at any time during the term of the transaction, prepayment of the outstanding balance due will require the recipient to pay finance charges other than interest accrued since the recipient's last payment, the following statement: "If you payoff

the financing faster than required, you will still be required to pay all or a portion of the finance charge, up to \$[maximum non-interest finance charge] based upon our estimates.”

- (B) In all other cases, the following statement: “If you pay off the financing faster than required, you will not be required to pay any portion of the finance charge other than interest owed since your last payment.”

(11) In the ninth row, the second and third columns shall be combined and shall include:

- (A) If, at any time during the term of the transaction, prepayment of the outstanding balance due will require the recipient to pay additional fees and charges not included in the finance charge, the following statement: “If you pay off the financing faster than required, you must pay additional fees ~~not already included in the finance charge~~ of [amount and description of fees].”

- (B) In all other cases, the following statement: “If you pay off the financing faster than required, you will not be required to pay additional prepayment fees ~~not already included in the finance charge~~.”

(12) If the contract provides for periodic payments that are not monthly, the provider shall insert one additional row below the fourth row, and the additional row shall include only the following information:

- (A) In the first column, the following language: “Estimated Monthly Cost.”
- (B) In the second column, the monthly cost that the recipient will pay over the term of the transaction. If the provider anticipates that the estimated monthly cost will vary over the term of the transaction, either due to changes in the recipient’s income through the particular payment channel, a change in the split rate, or some other reason provided for in the contract, the provider shall list the estimated monthly costs and the time periods when those estimates apply. For example:

Months 1-2:  
\$600/month

Months 3-6:  
\$1200/month

Month 7: \$1000/month

- (C) In the third column, a description of how the provider calculated the estimated monthly cost. For example: “Although you do not make payments on a monthly basis, this is our calculation of your average monthly cost based upon the payment amounts disclosed below.”

Note: Authority cited: Section 22804, Financial Code. Reference: Sections 22800, 22802, 22803 and 22804, Financial Code.

#### **§ 2068 Disclosure Formatting for All Other Transactions**

(a) Disclosures for commercial financing that does not meet the definition of a closed-end transaction, sales-based financing, commercial open-end credit plan, factoring transaction, lease financing, or asset-based lending transaction shall comply with the following formatting requirements:

- (1) The provider shall present the required disclosures in a table consisting of seven rows and three columns.
- (2) The first row of the table shall include only the following information:
  - (A) In the first column, the following language: "Funding You Will Receive".
  - (B) In the second column, the amount of funds that will be provided to the recipient, excluding any deductions such as origination charges and amounts used to pay off other financings.
  - (C) In the third column, a description of how the amount in the second column was calculated, including the amount and description of any deductions. For example: "This is your advance amount of [advance amount] minus the [amount and description of fees deducted] that will be deducted."
- (3) The second row of the table shall include only the following information:
  - (A) In the first column, the following language: "Annual Percentage Rate (APR)."
  - (B) In the second column, the annual percentage rate calculated in accordance with section 3001 of these rules.
  - (C) In the third column, the following in order:
    - (i) "APR is the cost of your financing expressed as a yearly rate. APR incorporates the amount and timing of the funding you receive, and payments paid by you or on your behalf to [financer]. APR is not an interest rate."
    - (ii) A description of any assumptions made by the provider to calculate APR.
- (4) The third row of the table shall include only the following information:
  - (A) In the first column, the following language: "Finance Charge".
  - (B) In the second column, the finance charge calculated in accordance with section 3010 of these rules.
  - (C) In the third column, the provider's calculation of the finance charge, with the amount and description of each expense that is included in the finance charge.
- (5) The fourth row of the table shall include only the following information:
  - (A) In the first column, the following language: "Payment".
  - (B) The second and third columns shall be combined, and shall contain the following information in order:
    - (i) The amount of each periodic payment, followed by a forward slash (/) and the frequency of each periodic payment. If the provider anticipates that the periodic payment amount will vary over the term of the transaction, the provider shall list all periodic payment amounts and the time periods when those payments apply. For example:

Months 1-2:

\$20/day

Months 3-7:

\$40/day

- (ii) The date and amount of any irregular payments listed in chronological order.

- (6) The fifth row of the table shall include only the following information:
  - (A) In the first column, the following language: "Term".
  - (B) In the second column, the term of the transaction.
  - (C) In the third column, an explanation of the term. For example: "If you make all the payments required by the contract, you will make your last payment in 48 months."
- (7) In the first column, the sixth and seventh rows shall be combined and shall include the following language: "Prepayment."
- (8) In the sixth row, the second and third columns shall be combined and shall include only:
  - (A) If, at any time during the term of the transaction, prepayment of the outstanding balance due will require the recipient to pay finance charges other than interest accrued since the recipient's last payment, the following statement, "If you pay off the financing faster than required, you will still be required to pay all or a portion of the finance charge, up to \$[maximum non-interest finance charge]."
  - (B) In all other cases, the following statement: "If you pay off the financing faster than required, you will not be required to pay any portion of the finance charge other than interest owed since your last payment."
- (9) In the seventh row, the second and third columns shall be combined and shall include:
  - (A) If, at any time during the term of the transaction, prepayment of the outstanding balance due will require the recipient to pay additional fees and charges not included in the finance charge, the following statement: "If you pay off the financing faster than required, you must pay additional fees ~~not already included in the finance charge~~ of [amount and description of fees]."
  - (B) In all other cases, the following statement: "If you pay off the financing faster than required, you will not be required to pay additional prepayment fees ~~not already included in the finance charge~~."
- (10) If the contract provides for periodic payments that are not monthly, the provider shall insert one additional row below the third row, and the additional row shall include only the following information:
  - (A) In the first column, the following language: "Monthly Cost."
  - (B) In the second column, the monthly cost that the recipient will pay over the term of the transaction. If the provider anticipates that the estimated monthly cost will vary over the term of the transaction, the provider shall list the estimated monthly costs and the time periods when those estimates apply. For example:

Months 1-2:

\$600/month

Months 3-6:  
\$1200/month

Month 7:  
\$1000/month

(C) In the third column, a description of how the provider calculated the monthly cost. For example: "Although you do not make payments on a monthly basis, this is our calculation of your average monthly cost based upon the payment amounts disclosed below."

(11) If the contract provides for multiple payment options, the provider shall insert one additional row above the first row, and in that row, all three columns shall be combined, resulting in a single cell. In that cell, the provider shall include a statement explaining how the provider has based the disclosure on the minimum payment permitted under the contract.

Note: Authority cited: Section 22804, Financial Code. Reference: Sections 22800, 22802, 22803 and 22804, Financial Code.

#### **§ 2070. Signatures.**

- (a) Prior to consummating a commercial financing, a financier shall obtain a copy of the disclosures made pursuant to sections 22802 and 22803 of the Code that are signed by the recipient. Where the recipient is not a natural person, a natural person authorized to sign on behalf of the legal entity may sign the disclosure, provided that the natural person is not a broker. Such disclosures may be transmitted between the recipient and the provider via electronic transmission and utilizing electronic signatures, regardless of whether subsequent financing agreements, amendments and supplements are provided to the recipient in person, by mail or electronically.
- (b) If a commercial financing transaction is consummated electronically, a provider may obtain a recipient's signature on the required disclosures electronically or by facsimile.

Note: Authority cited: Section 22804, Financial Code. Reference: Sections 22800, 22802, 22803 and 22804, Financial Code.

#### **§ 2071. Thresholds for Disclosure**

- (a) For the purpose of determining whether the amount of a commercial financing offer is equal to or less than \$500,000, a provider shall:
  - (1) For open-end credit plans, use the approved credit limit.
  - (2) For asset-based lending transaction:
    - (A) Use the approved credit limit, if transaction meets all of the following requirements:

- (i) The provider offers the recipient an agreement that describes the general terms and conditions of the commercial financing transaction that will occur under the agreement;
    - (ii) The approved credit limit exceeds \$500,000; and
    - (iii) The parties to the asset-based lending transaction agree in writing prior to execution of their agreement that an amount exceeding \$500,000 is reasonably expected to be unpaid and outstanding at some point during the agreement.
  - (B) If the asset-based lending transaction does not meet all of the requirements listed in subparagraph (a)(2)(A) above, the commercial financing offer shall be considered less than or equal to \$500,000.
- (3) For a factoring transaction,
- (A) Use the approved advance limit, if the transaction meets all of the following requirements:
    - (i) The provider offers the recipient an agreement that describes the general terms and conditions of the commercial financing transaction that will occur under the agreement;
    - (ii) The approved advance limit exceeds \$500,000; and
    - (iii) The parties to the factoring transaction agree in writing prior to execution of their agreement that at some point during the agreement, an amount exceeding \$500,000 is reasonably expected to be advanced to the recipient for legally enforceable claims that have not yet been paid.
  - (B) If the factoring transaction does not meet all of the requirements listed in subparagraph (a)(3)(A) above, the commercial financing offer shall be considered less than or equal to \$500,000.
- (4) For lease financing:
- (A) If the financier does not select, manufacture or supply the goods to be leased, use the net cost to the financier to acquire the property to be leased;
  - (B) If the financier selects, manufactures or supplies the goods to be leased, use the price that the financier would sell the goods for in a cash transaction, minus any down payment or other deposit to be paid by the recipient.
- (5) In all other transactions, use the total amount of funds to be provided by the provider to the recipient or by the provider on behalf of the recipient in connection with the commercial financing (including amounts used to pay off other financings).

Note: Authority cited: Section 22804, Financial Code. Reference: Sections 22800 and 22804, Financial Code.

**§ 2089. Commercial Financings with Multiple Payment Options; Balances Payable on Demand.**

- (a) For commercial financings that offer multiple payment options to the recipient, the provider shall calculate required disclosures based upon the minimum payments allowed under the contract.
- (b) For commercial financings where the balance due is payable on demand, the provider shall calculate required disclosures based upon an assumed term of one year unless the provider reasonably anticipates that the balance will be repaid more quickly. If an alternate maturity date is stated in the legal obligation between the parties, the disclosures shall be based on that date.

Note: Authority cited: Section 22804, Financial Code. Reference: Sections 22800, 22802, 22803 and 22804, Financial Code.

**§ 2091. Estimates – Sales-Based financing (Accounts Receivable Purchase Transactions) – Historical Method.**

(a) This section shall apply only to sales-based financing. (b) With respect to any assumptions about a recipient's future monthly sales, income, or receipts necessary to calculate the disclosures required by this chapter, a provider shall use the "estimated monthly sales, income, or receipts projection" described below:

(1) The estimated monthly sales, income, or receipts projection shall be calculated as the recipient's historical average sales volume or income with respect to the particular payment channel or mechanism. (2) A provider shall fix the number of months considered to determine the recipient's average monthly historical sales or income, provided that the period of historical data used by the provider shall not be less than four (4) months or more than twelve (12) months.

(3) A provider shall use the same number of months to determine all recipients' average historical sales or income, except where a recipient has not been in operation for the number of months set by the provider.

(4) When a recipient has not been in operation for the number of months set by the provider as described in subdivision (b)(3) of this section, the provider may calculate the recipient's historical average sales volume or income with respect to the particular payment channel or mechanism using an average from the months the recipient has been in operation.

(c) If a provider must make additional estimates or assumptions other than a recipient's estimated monthly sales or receipts projection in order to provide disclosures required by this chapter, the provider shall:

(1) Base those estimates or assumptions on the best information reasonably available to the provider at the time of the disclosure; (2) State clearly that any disclosure based upon an estimate or assumption is an "Estimate" by adding the word "Estimate" to the descriptive language of any required disclosure under this chapter.

(3) State clearly any assumptions or estimates used as the basis for the disclosure in any description associated with the disclosure.

Note: Authority cited: Section 22804, Financial Code. Reference: Sections 22800, 22802, 22803 and 22804, Financial Code.

**§ 2092. Estimates – Sales-based financing (Accounts Receivable Purchase Transactions) – Underwriting Method.**

- (a) This section shall apply only to sales-based financing:
- (1) With respect to any assumptions about a recipient's future sales, income or receipts, and as an alternative to the methods described in Section 2091 for calculating disclosures required by this chapter, a provider may elect to calculate the required disclosures in accordance with this section.
  - (2) A provider shall calculate the disclosures using an "internal estimated sales, income, or receipts projection" through the particular payment channel or mechanism designated in the contract.
  - (3) The "internal estimated sales, income, or receipts projection" through the particular payment channel or mechanism shall be calculated using the best information reasonably available to the provider.
  - (4) Once every four months, a provider who makes disclosures based upon internal estimated sales projections shall conduct an audit of its commercial financings.
    - (A) The audit shall cover all sales-based financings paid off during the previous four-month period where the provider made disclosures based upon internal estimated sales projections. The audit shall not include sales-based financings where:
      - (i) The provider or financier initiated legal action against the recipient in court or arbitration for breach of the contract or to collect amounts due under the contract; or
      - (ii) The provider or financier stopped collection of amounts due under a contract after determining that the recipient had violated the terms of the contract.
    - (B) The provider shall calculate the retrospective annualized rate for each sales-based financing in the audit. With respect to financing where a lump sum payment is used to pay off the financing faster than required by the contract, a provider may calculate the retrospective annualized rate by ignoring the lump sum payment and assuming that the contract would have been repaid in periodic payments that are an average of the past periodic payments under the contract.
    - (C) The provider shall calculate the percentage of the difference between subtract the disclosed annualized rate from and the retrospective annualized rate for each sales-based financing in the audit. The provider shall subtract the retrospective annualized rate from the disclosed annualized rate, and divide this difference by the disclosed annualized rate. The difference percentage resulting from this calculation shall be called the "APR spread".
    - (D) The provider shall find the median APR spread for all sales-based financings in the audit. The median shall be called the "audited APR spread."
  - (5) After completing its audit, the provider shall calculate the weighted average of the audited APR spreads for the last three audits and the last five audits using the total number of transactions used to calculate the audited APR spreads for each audit period. This provision does not require a provider to calculate a weighted average for the last three audits if the provider has not conducted three audits, or the weighted average for the last five audits if the provider has not conducted five audits.

**Commented [A14]:** As part of Recommendation 1, RBLC suggests that the "APR spread" be calculated as a percentage of the disclosed APR, not as the number of percentage points of difference.

If the quoted APR was 1% and the actual APR was 10%, this would fall within a 10% threshold, but be quite inaccurate. Similarly, an actual APR of 411% vs a disclosed APR of 400% would fall outside of the 10% tolerance, while still having given the borrower a reasonably accurate assessment of the price.



- (A) If the weighted average for the last three audits is greater than 10%, the provider shall not utilize the method described in this section to calculate the required disclosure terms for 24 months, but shall instead employ the methods described in Section 2091 unless the provider determines that the method described in Section 2091 would have yielded a higher weighted average.
- (B) If the weighted average for the last five audits is greater than 5%, the provider shall not utilize the method described in this section to calculate the required disclosure terms for 24 months, but shall instead employ the method described in Section 2091 unless the provider determines that the method described in Section 2091 would have yielded a higher weighted average.
- (6) Following the end of the 24 month period described in part (5e) above, the provider may begin calculating estimated payments, term and annual percentage rate in accordance with this section only if the provider has made a good-faith effort to modify its method for calculating internal estimated sales projection to make its disclosures more accurate.
- (7) If a provider must make additional estimates or assumptions other than an estimate of a recipient's future sales, income or receipts in order to provide disclosures required by this chapter, the provider shall:
- (A) Base those estimates or assumptions on the best information reasonably available to the provider at the time of the disclosure;
- (B) State clearly that any disclosure based upon an estimate or assumption is an "Estimate" by adding the word "Estimate" to the descriptive language of any required disclosure under this chapter; and
- (C) State clearly any assumptions or estimates used as the basis for the disclosure in any description associated with the disclosure.
- (8) A provider that elects to make disclosures based upon internal estimated sales projections in accordance with this section shall annually report to the Department the following information for each financing account repaid within the previous 12 months:
- (A) The amount financed.
- (B) The projected total payments per month disclosed to the recipient.
- (C) The average monthly payment amount made by the recipient, excepting any lump sum payment is used to pay off the financing faster than required by the contract.
- (D) The estimated APR disclosed to the recipient.
- (E) The retrospective APR that is calculated upon repayment by the recipient, as described in § 2092(4)(B).
- (F) The APR spread, as described in § 2092(4)(C).
- (G) The aggregate audited APR spread, as described in § 2092(4)(D) for each audit within the reporting period.
- (9) Information provided to the Department by a provider pursuant to this section shall be considered confidential and not subject to disclosure by the Department pursuant to the Public Records Act (Government Code Section 6250 et seq.).

**Commented [A15]:** Should read "Part (5)" not "Part (e)"

**Commented [A16]:** To implement Recommendation #1.

The Reporting suggested here is crucial for the underwriting method to include sufficient accountability to match the flexibility offered.

Note: Authority cited: Section 22804, Financial Code. Reference: Sections 22800, 22802, 22803 and 22804, Financial Code.

#### § 3000. Annualized Rate Disclosure.

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

~~(b)~~ (b) When a provider states a price or a financing amount to a recipient during an application process for commercial financing, the provider shall also state annual percentage rate, using that term or the abbreviation "APR."

~~(c)~~ If other metrics of financing cost are disclosed or used in the application process of a commercial financing, these metrics shall not be presented as a "rate" if they are not the annual interest rate or the annual percentage rate. The term "interest", when used to describe a percentage rate, shall only be used to describe annualized percentage rates, such as the annual interest rate.

Note: Authority cited: Section 22804, Financial Code. Reference: Sections 22800, 22802, 22803 and 22804, Financial Code.

#### § 3001. Calculation of Annual Percentage Rate.

- (a) The annual percentage rate is a measure of the cost of credit, expressed as a yearly rate, that relates the amount and timing of value received by the recipient to the amount and timing of payments made to the provider. For purposes of this subchapter, the annual percentage rate shall be determined in accordance with either the United States Rule method or the actuarial method, as both are set forth in Appendix J, 12 C.F.R. Part 1026 (effective December 30, 2011), and which is incorporated herein by this reference.
- (b) The annual percentage rate shall be considered accurate if it is not more than 1/8 of 1 percentage point above or below the annual percentage rate determined in accordance with paragraph (a) of this section.
- (c) The annual percentage rate calculation shall include all finance charges as that term is defined in section 3010 of these rules.
- (d) When calculating the annual percentage rate, a provider may assume that it can collect payments on every calendar day, regardless of bank holidays, weekends, or other days that would otherwise delay or accelerate the provider's collection of a payment.
- (e) When calculating the required disclosures for commercial open-ended credit plans, the provider shall assume that the recipient borrows the approved credit limit at origination and makes no subsequent draws and that minimum on-time payments are made pursuant to the contract.

Note: Authority cited: Section 22804, Financial Code. Reference: Sections 22800, 22802, 22803 and 22804, Financial Code.

#### § 3002. Additional Assumptions for Factoring Transactions

- (a) When calculating the required disclosures in accordance with section 3000 of these rules for factoring transactions, to provide a disclosure based upon a single transaction as described by section 22802 of the Code, the provider shall assume that it will receive full payment of the legally enforceable claim upon the date that legally enforceable claim becomes due and payable.
- (b) When calculating the required disclosures in accordance with section 3000 of these rules for factoring transactions, to provide a disclosure based upon an example transaction as described by section 22803 of the Code, the provider shall assume that it will receive full payment of the legally enforceable claim upon the date that results from adding the term to the date the disclosure is made.

**Commented [A17]:** To implement Recommendation #3.

Any time price is referenced but the full disclosure is not triggered (such as after the disclosure is presented and the terms have not changed) the APR would be presented.

This is a light version of the "trigger terms" section of TILA/Reg Z, intended to improve small business awareness of the cost in the most comparable term, APR, through the transaction.

**Commented [A18]:** To implement Recommendation #2.

This is to prohibit description of fees as "rates" and "interest." This common practice has been shown to be misleading in Federal Reserve research, and in the daily experience of our coalition members serving small businesses.

Note: Authority cited: Section 22804, Financial Code. Reference: Sections 22800, 22802, 22803 and 22804, Financial Code.

**§ 3003. Estimated Annual Percentage Rate – Sales-based financing**

- (a) When calculating the estimated payments and reasonably anticipated true-ups for sales-based financing, a provider shall use the estimated monthly sales, income or receipts projection described in subdivision (b) of section 2091 of these rules or the internal estimated sales, income, or receipts projection described in subdivision (a)(3) of section 2092 of these rules, accounting for:
  - (1) Specified payment amounts;
  - (2) Changes to the split rate over time;
  - (3) Contractual provisions requiring a minimum payment amount; and
  - (4) Penalty payments required when a payment or series of payments falls below a contracted threshold.
  - (5) Any other finance charges that may be reasonably anticipated based upon the estimated monthly sales, income, or receipts projection or the provider's internal estimated sales, income, or receipts projection.

(b) When calculating estimated monthly cost, finance charge, term, and annual percentage rate for the sales-based financing, a provider shall use the estimated monthly, income or receipts sales projection described in subdivision (b) of section 2091, or internal estimated sales, income, or receipts projection described in subdivision (a)(3) of section 2092 of these rules, accounting for the following:

- (1) Specified payment amounts;
- (2) Changes to the split rate over time;
- (3) Contractual provisions requiring a minimum payment amount;
- (4) Penalty payments required when a payment or series of payments falls below a contracted threshold;
- (5) Reasonably anticipated true-ups; and
- (6) Any other finance charges that may be reasonably anticipated based upon the estimated monthly sales, income, or receipts projection or the provider's internal estimated sales, income, or receipts projection

Note: Authority cited: Section 22804, Financial Code. Reference: Sections 22800, 22802, 22803 and 22804, Financial Code.

### 3010. Finance Charge.

(a) The "finance charge" for a commercial credit transaction is the sum of:

- (1) For all commercial financing transactions, all charges that would be included in the finance charge under 12 C.F.R. part 1026.4 (effective April 1, 2019), if the transaction were a consumer credit transaction and the financier were a creditor under federal law. This paragraph is intended to require finance charges to include any charge that would be a finance charge under 12 C.F.R. part 1026.4, regardless of whether the transaction is question would be considered an "extension of credit" under federal law and regardless of whether the financier would be considered a "creditor" under federal law;
- (2) In any accounts receivable purchase transaction that is not a factoring transaction, the discount taken on the face value of the accounts receivable;
- (3) In a factoring transaction, the difference between the face value on the invoice and the amount paid directly to the recipient upon assignment of the legally enforceable claim to the financier, but excluding reserve amounts, only if the financier reasonably anticipates that it will return all reserve amounts to the recipient once it has been paid for the legally enforceable claim or claims assigned by the recipient or upon termination of the contractual relationship between the financier and the recipient, properly crediting payments made by account debtors and previous collections by the financier from the recipient, all amounts held in reserve, and payments by insurers on defaulted accounts. In determining what the financier can reasonably anticipate, the financier shall consider past performance of similar contracts (both those made to the recipient and other similar recipients) and the policies and procedures of the financier; and
- (4) In any lease financing transaction, the sum of lease payments (including any regular periodic payments and irregular payments) and price of the purchase option that the lessee may pay to acquire the leased goods at the end of the lease, minus the amount of funds provided that is disclosed to the recipient in accordance with subdivision (a)(2)(B) of section 2066 of these rules.

(5) For all commercial financing transactions requiring that the recipient to pay off the balance of an existing loan or advance outstanding from the same provider, any prepayment charge or penalty required to be paid on the existing financing. For financing for which the total repayment amount is calculated as a fixed amount, the prepayment charge is equal to the original finance charge multiplied by the required prepayment

**Commented [A19]:** To implement Recommendation #4

If the finance charge does not reflect charges by the provider incurred as a requirement of obtaining the financing, it is incomplete and does reflect the cost of the financing.

amount as a percentage of the total repayment amount, minus any portion of the total repayment amount forgiven by the provider at the time of prepayment.

- (b) For products where any part of the finance charge is based upon interest that accrues on the outstanding principal balance owed by the recipient, the interest charge adjusts over time, and it is not possible to calculate the interest charges in advance for the entire term of the transaction because the charge adjusts based upon a benchmark rate plus a margin, the provider shall calculate the interest charges for periods of time when the interest charge cannot be calculated in advance based upon the benchmark rate in effect at the time of disclosure and the margin.

Note: Authority cited: Section 22804, Financial Code. Reference: Sections 22800, 22802, 22803 and 22804, Financial Code.

**§ 3021. Asset-based lending: Example transaction.**

- (a) The alternative disclosures to a recipient under section 2062 of these rules shall be made using an example transaction and in accordance with the formatting requirements of section 2067 of these rules. The example transaction shall be based on the proposed agreement governing the actual transaction between the provider and recipient with the following parameters, as applicable:
  - (1) For asset-based lending transactions where the finance charge, annual percentage rate, or term varies based upon the type of advance received, where the provider offers the recipient an agreement that describes the general terms and conditions of the commercial financing transactions that will occur under the agreement, and where the financier provides disclosures based upon an example of a transaction that could occur under the agreement under section 22803 of the Code, the provider shall give the recipient a separate disclosure for each type of advance.
  - (2) Maximum draw amount. If the agreement between a financier and recipient permits an advance of funds to the recipient up to and including an approved credit limit, the example transaction used in making the disclosures shall assume the recipient has drawn half the approved credit limit. For example, if the approved credit limit under the agreement is \$50,000, the example transaction shall assume the recipient has drawn \$25,000.
  - (3) No maximum draw amount. If the agreement between a provider and recipient does not specify a maximum approved credit limit, the example transaction used in making the disclosures shall assume the recipient has drawn \$10,000.

Note: Authority cited: Section 22804, Financial Code. Reference: Sections 22800, 22802, 22803 and 22804, Financial Code.

**§ 3022. Factoring: Example Transaction.**

- (a) For factoring transactions where the finance charge, annual percentage rate, or term varies based upon the type of the legally enforceable claim assigned, where the provider offers the recipient an agreement that describes the general terms and conditions of the commercial financing transactions that will occur under the agreement, and where the financier provides disclosures based upon an example of a transaction that could occur under the agreement

under section 22803 of the Code, the provider shall give the recipient a separate disclosure table under section 2064 of these rules for each type of legally enforceable claim.

- (b) Maximum draw amount. If the agreement between a financier and recipient permits an advance of funds to the recipient up to and including a maximum aggregate purchase price for legally enforceable claims that have not yet been paid by the account debtor, the example transaction used in making the disclosures shall be equal to half the maximum aggregate purchase price. For example, if the financier will advance up to \$100,000 on unpaid legally enforceable claims, the example transaction shall assume the recipient has drawn \$50,000.
- (c) No maximum draw amount. If the agreement between a provider and recipient does not specify a maximum aggregate purchase price for legally enforceable claims that have not yet been paid by the account debtor, the example transaction used in making the disclosures shall assume the recipient has drawn \$10,000.

Note: Authority cited: Section 22804, Financial Code. Reference: Sections 22800, 22802, 22803 and 22804, Financial Code.

#### **§ 3023. Duties of Financiers and Brokers.**

- (a) A financier shall:
  - (1) Provide a copy of compliant disclosures to a broker, whenever a financier provides a broker with a financing amount, rate or price quote for commercial financing relating to a recipient, based upon information from, or about, the recipient, the financier; and
  - (2) Maintain a copy of each disclosure that it generates pursuant to this chapter for a period of at least four years following the date that the disclosure is presented to the recipient or provided to a broker.
  - (3) Maintain a copy of the evidence of transmission of the disclosures provided by a broker to the financier in compliance with subdivision (b) for a period of at least four years following the date that the disclosure is presented to the recipient.
  - (4) Develop procedures reasonably designed to ensure that recipients receive the disclosures compliant with this chapter at the time that the financing amount, rate or price quote is provided to the recipient by the broker, if the financier communicates financing amount, rate or price quotes to brokers. These procedures shall include:
    - (A) Contractual requirements that brokers timely provide to the financier documentation of transmission of the disclosure (including timing of transmission) to the recipient;
    - (B) Timely investigation of facts that would give a financier reasonable notice that a broker has not provided disclosures to recipients as required by subdivision (b); and
    - (C) Discontinuation of relationships with any broker who the financier has found has not complied with subdivision (b).
- (b) A broker shall not provide a recipient with a specific amount, rate, or price quote for commercial financing based upon information from, or about, the recipient, until the broker transmits the disclosures required by subdivision (a)(1) of this section, unaltered, to the recipient. After a broker transmits disclosures to the recipient, the broker shall provide evidence of transmission of the disclosures to the financier, including the time of transmission.
- (c) This section shall not be construed to:
  - (1) Require a broker to evaluate the accuracy of the disclosures provided by the financier;

- (2) Create any liability for a broker if the disclosures that the financier provides do not comply with this Chapter or Division 9.5 of the Code; or
- (3) Limit any liability that may arise when a broker makes representations concerning the commercial financing.

Note: Authority cited: Section 22804, Financial Code. Reference: Sections 22800, 22802, 22803 and 22804, Financial Code.

**§ 3024. Other Laws.**

- (a) The rules of this Chapter are not intended to:

- (1) Clarify or interpret existing California law with respect to the definitions of loan, sale, and lease, as those terms may apply to the commercial financing transactions regulated by this Chapter.
- (2) Affect the Department of Business Oversight's authority to regulate any person or transaction under other laws under its jurisdiction, except to the extent permitted by section 22805 of the Code.

Note: Authority cited: Section 22804, Financial Code. Reference: Sections 22800 and 22804, Financial Code.

**§ 3025. Recipient's Relationship to California**

- (a) The requirement of section 22802, subdivision (a), of the Code, applies only to recipients whose business is principally directed or managed from California.

Note: Authority cited: Section 22804, Financial Code. Reference: Sections 22800, 22802, 22803 and 22804, Financial Code.