Innovative Lending Platform Association

October 27, 2020

SENT VIA ELECTRONIC MAIL

California Department of Financial Protection and Innovation, Legal Division
Attn: Mark Dyer, Regulations Coordinator
1515 K Street, Suite 200
Sacramento, California 95814-4052
regulations@dbo.ca.gov

Re: Invitation for Comments on Initial Proposed Regulations, California Code of Regulations Title 10, Chapter 3

Dear Mr. Dyer and Mr. Alvarez:

The Innovative Lending Platform Association (ILPA) appreciates the opportunity to provide comments on the California Department of Financial Protection and Innovation's (DFPI) draft regulations for SB 1235 (Chapter 1011, Statutes of 2018). ILPA applauds DFPI's goal of ensuring that small businesses receive comprehensive and transparent financing disclosures and for engaging in a thoughtful, collaborative approach to promulgating regulations for SB 1235. While we generally support DFPI's draft regulations, ILPA is reiterating its request that DFPI consider approving alternative forms for small business financing disclosures. Particularly disclosure forms that are currently widely used and recognized as effective disclosure tools by small businesses and third parties alike.

As you know, ILPA is the leading trade organization for online financing and service companies serving small businesses. Our member companies[1] share a commitment to the health and success of our nation's small businesses and are dedicated to advancing best practices and standards that promote responsible innovation and access to capital. ILPA strongly supports transparency in small business financing disclosures, and our member companies are committed to providing small businesses with responsible and transparent financing options. In 2016, ILPA launched an industry-first, voluntary model disclosure tool – the SMART Box® – that presents small businesses with comprehensive pricing metrics and identifies key financing terms in plain, easy-to-understand language.

The SMART Box[2] empowers small business owners and operators to better understand and compare their financing options in the marketplace and from specific providers. To develop the SMART Box, ILPA launched a 90-day national engagement period in 2016 to foster an open dialogue with interested financing platforms, trade associations, regulators, policymakers, non-profit organizations, small business advocates, customers of ILPA member companies and other small business owners. ILPA also conducted surveys of small business stakeholders and engaged directly with networks of Community Development Financial Institutions (CDFIs) and community

[1] Members of ILPA include BFS Capital, BlueVine, Fundbox, Funding Circle, Kabbage, Lendio, Mulligan Funding, OnDeck, Paynet and The Business Backer
[2] See www.innovativelending.org/smart-box

lenders. Most importantly, ILPA consulted with small business owners to identify the pricing metrics they deemed most useful when evaluating and comparing the cost of financing. These discussions and surveys helped inform the final disclosures, which are periodically updated to reflect ongoing feedback from customers and public policy stakeholders. As a result, the SMART Box sets a standard for clear, uniform disclosures in financing products to help small businesses make more informed financing decisions, whether they are considering how a certain product fits a business need or how it compares to other financing options. We regularly review the SMART Box to ensure that it captures consistent and comparable metrics for all of our members' products. A summary of SMART Box disclosure elements is below:

1. Financing Amount
2. Disbursement Amount, after any fees deducted or withheld at disbursement
3. Repayment Amount
4. Term or Estimated Term[3]
5. Cost Comparison Metrics[4]
    a. Total Cost of Capital[5]
    b. APR or Estimated APR[6]
    c. Cents on the Dollar[7]
6. Periodic Payment Amount or Payment Schedule
    a. If payments are a fixed amount, provide the payment amount and frequency (*e.g.*, daily, weekly, monthly), <u>and</u> the average monthly payment amount
    b. If payments are a variable amount, provide a payment schedule or a description of the method used to calculate payment amounts and frequency of payments, <u>and</u> the average monthly payment amount[8]
7. Prepayment Policy, including a cross reference to a description of any fees, expenses or charges due when the financing is paid in full

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[3] When providing the Estimated Term for products with variable payments and/or no fixed term, we recommend providing the total time for repayment assumed in the underwriting process.

[4] To calculate APR and Total Cost of Capital for certain products, the provider must make certain assumptions, which may not be borne out or ultimately reflect the costs paid by the customer. To provide the APR for merchant cash advances or other products without a fixed term, the provider must estimate the term. To provide the Total Cost of Capital for a line of credit product with no set draw amount, the provider must assume a draw amount.

[5] The Total Cost of Capital is the total dollar cost to be charged to the customer, assuming the customer pays according to the original or assumed payment schedule, including all fees and charges that cannot be avoided by the customer (e.g., origination fee, interest expense, and other upfront fees). When providing the Total Cost of Capital for a line of credit product, we recommend assuming the entire line amount is drawn at the time of disbursement. In such case, we recommend further that disclosures expressly note that the Total Cost of Capital is estimated based on an initial draw of the full line amount held for the full term, and that the quoted Total Cost of Capital will not be accurate if the business draws a different amount for a different period of time.

[6] We recommend that APR be calculated consistent with the APR methodology provisions of TILA and Regulation Z. When providing Estimated APR for a financing with a variable term, we recommend calculating based on the daily, weekly or monthly delivery of receivables or payments from the business that is assumed by the provider in the underwriting process. In such case, we recommend further that disclosures explain that the Estimated APR is intended as a good faith estimate and may not be accurate if the business repays more quickly or slowly than as reflected in the Estimated Term.

[7] The Cents on Dollar metric expresses the total amount of interest, in cents, paid by the customer per dollar received. This amount is exclusive of fees.

[8] To calculate the average monthly payment for certain products, the provider must make certain assumptions which may not be borne out or ultimately reflect the costs paid by the customer. ILPA believes small businesses should be provided with the estimated monthly payment in dollars to allow easy comparisons of costs across products and to empower small businesses owners to understand the effect of the financing on their monthly revenue and expenses. Our research found that it is compelling and intuitive for business owners to think of their business finances in terms of "dollars in" and "dollars out" on a monthly basis.

SMART Box Support from Respected Third Parties

This industry-driven disclosure is endorsed by ILPA members, including some of the nation's largest online lending platforms, and is an emerging international standard for small business lending disclosures[9]. The SMART Box has also been nationally recognized by the Bipartisan Policy Center and the Federal Reserve for providing increased transparency to customers:

> "[The SMART Box] provides easy-to-understand statistics, such as APR and average monthly payments, in one place…" *Bipartisan Policy Center (August 2018).*

> "Participants presented with [the SMART Box] … overwhelmingly liked the format and the wealth of information contained in the table. Among their comments: 'I like this and see what is important to me!'; 'This is exactly how I would like to see the breakdown'; 'This is straight to the point'; and 'It has everything a borrower would want to know'." *Federal Reserve Report (June 2018).*

> "The SMART Box™ is a beautiful thing because it shows you everything upfront and at a glance. I can see the total cost of capital, loan fee, APR, and other metrics in one place. I thought this was standard, but I've discovered that not everyone uses the SMART Box." *Taleinna Simon – Durham Disposal, a Kabbage Customer (January, 2019).*

ILPA's success in providing customers with a clear, straightforward understanding of the terms and costs of a financing demonstrates why SB 1235's disclosure requirements are so important and how lessons learned from our use of the SMART Box can be particularly informative. Ultimately, we hope that SB 1235 implementing regulations will provide essential protections while maintaining flexibility so that companies can provide a single set of disclosures that comply with both SB 1235 and other state disclosure laws as they move forward, ensuring all small business financers will meet the same standard of transparency that ILPA has been setting for years. We look forward to continuing to work with DFPI on the implementation of SB 1235.

I. The Future of SMART Box and the Requirements of SB 1235

ILPA believes SMART Box embodies the spirit and purpose of SB 1235 by providing a summary of key terms, clear and consistent pricing metrics, and calculations and explanations to help small businesses understand and compare the costs of their small business financing options. We strongly believe the SMART Box fully satisfies the disclosure requirements laid out in the legislation, which require providers to disclose:

(1) The total amount of funds provided.

(2) The total dollar cost of the financing.

(3) The term or estimated term.

(4) The method, frequency, and amount of payments.

(5) A description of prepayment policies.

(6) The total cost of the financing expressed as an annualized rate.

[9] Canada and Australia

However, the draft regulations are so prescriptive in their requirements – which include font sizes, specific chart row and column sizes, ordering of disclosure metrics, specific language to be included in the disclosures, and lack of ability to disclose additional clarifying information and metrics – that they would force ILPA members to abandon the SMART Box in order to comply with the disclosure form proposed by DFPI.

While the adoption of forms is clearly within the regulatory jurisdiction of DFPI, we urge, at a minimum, that any forms adopted mirror the format and headings of emerging national standards, and we stand ready to assist in that regard and are open to making certain changes to the SMART Box. We also note that SB 1235 does not prevent DFPI from approving additional compliant forms in the marketplace on a case by case basis. SB 1235 states "The commissioner shall adopt regulations governing the disclosures described" in the bill and that DFPI shall create "requirements concerning the time, manner, and format of the applicable disclosures described in" the bill.[10] This gives DFPI the authority to approve additional forms for disclosing the required metrics and the power to determine if those forms meet the "requirements concerning the time, manner, and format of the applicable disclosures."

This approach has been adopted by the California Department of Real Estate in its approval of alternative TILA-RESPA disclosures following the adoption of MLDS rules[11] and allows the Department to approve updated alternative forms without the delay of a formal rulemaking process. DFPI has considerable latitude to approve forms and variations of forms. California Financial Code Section 331 gives the Commissioner explicit authority to use "any method" to accept forms electronically, and Government Code 11340.9 expressly exempts "a form prescribed by a state agency or any instructions relating to the use of the form" from the formal requirements of the California Administrative Procedures Act. Moreover, DFPI is a participating agency in the recent expansion of the NMLS to include money transmitter licensees in the multi-state UUAR regime[12], which defines what specific fields are required and authorizes NMLS (CSBS) to continue development of form disclosures, subject to the requirements of Gov. C. 11340.9.

We reiterate our request for DFPI to implement a process for approving alternative and updated forms that meet the minimum statutory requirements laid out in SB 1235, and ILPA intends to seek confirmation from DFPI that SMART Box is an approved disclosure form.

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We look forward to continuing to work with the DFPI and Commissioner Alvarez on this important rulemaking process. If you have any questions, please do not hesitate to contact me at scott@innovativelending.org.

Best regards,

[redacted]

Scott Stewart, CEO
Innovative Lending Platform Association
cc: Charles Carriere, Counsel for the Commissioner at [redacted]

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[10] See https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201720180SB1235
[11] See http://www.dre.ca.gov/files/pdf/adv/MLDS%20and%20Loan%20Estimate%20Advisory.pdf
[12] See https://nationwidelicensingsystem.org/slr/common/Pages/UniformAuthorizedAgentDelegateReporting.aspx