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

October 28, 2020

California Department of Financial Protection and Innovation (DFPI)
Attn: Charles Carriere, Senior Counsel
One Sansome Street
Suite 600
Sacramento, CA 94104-4448

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

Dear Commissioner Alvarez,

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

The proposed Regulations are significantly improved from the previous draft regulations shared with the industry. However, the proposed Regulations still create a number of material issues that need to be addressed or the disclosures will be confusing and ineffective.

I. OUR COMPANY

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

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

II. COMMENTS

A. Definitions

(i) "At the time of extending a specific commercial financing offer" (Section 2057(a)(4)) – This phrase is defined to apply whenever a "specific amount, rate or price" is quoted to a recipient "based upon information from, or about, the recipient." The use of the word "about" creates material issues. All information a provider gives to a recipient is "about" that recipient in some fashion. So if a provider gave an example of how a transaction would work and used totally imaginary numbers that would still be "about" the recipient and arguably require disclosures. This would be the case even if the provider never obtained a bank statement from the recipient, never confirmed they own a business, and never quoted a rate or price. This is simply not workable and will lead to totally unreliable and incomplete disclosures. We suggest the "about" be deleted so that disclosures are given based on specific information "from the recipient."

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

Additionally, requiring the disclosures to be provided so early in the process will lead to significant issues given the high number of quotes that are typically provided. Some recipients want to see what the quote would be for a six, ten or twelve month term, which, according to the proposed Regulations, would require disclosures for each term. If a recipient wanted to see those same three quotes for both a closed-end transaction and a sales-based financing transaction, a provider would be required to give the recipient six disclosures. If each disclosure is approximately three pages, the recipient will receive

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

eighteen pages of disclosures to review. To make matters worse, the vast majority of commercial finance transactions are negotiated with multiple changes to the terms of the transaction. The proposed Regulations would require new disclosures each time a disclosed term changes (even when the changes work to the recipients favor). In the example above when the recipient would receive eighteen pages of disclosures, they would then get another eighteen pages or more when they renegotiate any term. This will happen frequently as the standard practice in the industry is to provide multiple quotes and to negotiate terms numerous times. This will result in an overwhelming number of disclosure forms and, as a result, recipients will likely just ignore the disclosures all together. This scenario is amplified if the recipient is looking at financing options from multiple providers (a very common practice).

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

The timing for the proposed disclosures is made even worse when you think about the technology advances industry participants are experiencing. For example, as part of our process, an account is created that displays the different terms and products available for that recipient. Once the recipient chooses which quote works best, the contract along with the terms are then sent to the recipient to be signed. The proposed Regulations require that all of the quotes be provided with the disclosures so we would have to program our system to generate all of the disclosure anytime a term changes, keep track of the disclosures, and send the disclosures via email, DocuSign, facsimile or by mail. Once the disclosures are signed, we would have to store them for four years. However, because each of those signed documents has a different specific offer, we would have to create six different accounts for the client so that each account will house each of those individual specific offers so they are properly segregated. Not only does this take up hard drive space, creating so many different accounts will also slow down the system.

Moreover, the majority of providers have some type of online recipient portal where either new or current recipients can apply for financing. Typically, the recipient will create an account and input information about the recipient. Based on the information received by the recipient, the provider is usually able to provide a maximum and minimum amount of financing that the recipient may qualify for. The recipient is then able to manipulate the financing tool (*e.g.* a financing slider that increases or decreases the financing while showing terms and fees) to show how much the financing may cost depending on how much financing the recipient obtains. Based on the definition for "extending a specific commercial financing offer" because the provider has obtained information about the recipient and has provided a specific amount and a term, the provider is then required to send a disclosure to the recipient for signature. That means that anytime a recipient decides to change the amount by sliding the bar (which in turn changes the specific amount and term) the provider would be required to provide a disclosure and obtain a signature. For example, let's say a recipient inputs information into the recipient portal and is shown that it may qualify for financing between $5,000.00 and $50,000.00. Theoretically, that recipient could adjust the slider in increments of one dollar ($5,001.00, $5,002.00, etc.) and the provider would be required to provide 45,000 disclosures and get all 45,000 disclosures signed. There is no reason to provide the recipient with all of these disclosures when the recipient is trying to determine which financing amount might make the most sense and is looking at the different quotes on its own.

Finally, the definition requires re-disclosure for amended terms. We suggest it be amended to make it clear that such re-disclosure would not be required for any changes that occur as a result of the recipient's default. It is common for transactions in default to be provided extensions (usually with no new fees). Such an extension is an increase in the term and under the current wording in the proposed Regulations would require another set of disclosures even if there are no new fees or rates. This is not the manner in which amendments and workouts are generally handled under TILA. Under 12 C.F.R. § 1026(a)(1), there must be a refinancing for new disclosures to be required. A refinancing is defined to include amendments where the rate is increased from the previously agreed upon rate but a change in payment amount or term as a result of a default is not a refinancing requiring new disclosures. We suggest the proposed Regulations be amended to follow this same definition or it will create material confusion. For example, if a recipient is in default and the term is extended, they would be given new disclosures showing no new rate or fees as all that changed was the term and payment amount as result of a default. Also, if there was no default but due to circumstances outside our clients' control (*e.g.*, COVID), we worked with our customers to reduce their payments until they were able to re-open, re-disclosure would be required under the proposed Regulations in order for us to offer that reduced payment. There is no new cost to the customer in this situation and the extension is a benefit to them. This type of modification should be encouraged and not made more difficult with disclosures that will be meaningless. This scenario raises the additional issue of whether yet another set of disclosures is required when the original terms are effective again after the temporary relief expires. The proposed Regulations do not address these scenarios at all. Because this regulation requires re-disclosure when terms of the loan are unchanged, it violates the Necessity standard[3] of the APA. It is not reasonably necessary to effectuate the purpose of the statute, in violation of CA Government Code section 11342.2.

(ii) Signatures (Section 2070) – The proposed Regulations require the provider to obtain a copy of the signed disclosures. It is unclear whether the provider is only required to obtain a copy of the signed disclosures which are associated with the actual financing the provider approved and funded or if the provider must obtain a signed copy of all the disclosures that it has provided to the recipients. It does not make sense for the provider to obtain signatures for all of the disclosures it provides or for the recipient to have to sign all of them. It would seem reasonable to only require providers to obtain the signed disclosure which represents the amount of financing the recipient actually receives. This is consistent with the wording in SB 1235(b) which states that a provider "shall obtain the recipient's signature on such disclosure before consummating the commercial financing transaction." As stated above, there could be extensive negotiations and upwards of six plus disclosures that are provided. Moreover, it does not make sense to require a recipient to sign a

[3] CA Government Code § 11349(a)

document that discloses terms the recipient has no intention of accepting. Recipients will simply not sign a disclosure document for a financing amount that it does not want. The recipient knows that the disclosures are going to be a part of the contract so by signing the document it would appear that the recipient is accepting that financing amount and is going to be bound by those terms, when in actuality the recipient has selected a completely different offer. Additionally, what happens when a recipient just refuses to sign a disclosure for an offer the provider is ready to close? Is the provider prohibited from closing the transaction even if they asked the recipient to sign the disclosures multiple times and that is documented in the provider's system of record? Furthermore, it is unclear if the provider needs to obtain only the signed disclosures it provided or all signed disclosures (*e.g.* disclosures provided by a broker). The way the proposed Regulations is currently worded seems to require the provider to obtain signed copies of all disclosures (whether or not made by the provider). We suggest this be limited to only disclosures provided by the provider. Based on this, we would suggest that the relevant language in section 2070 be changed to the below:

> (a) Prior to consummating a commercial financing, a financier shall request a copy of the disclosure that was made by the financier pursuant to 22802 and 22803 of the Code that is signed by the recipient and which is the disclosure that is associated with the commercial financing that the provider intends to issue. (We have no comments on the remainder of the definition.)

(iii) Sales-based financing (Section 2057(a)(22)) – Although the proposed Regulations attempt to differentiate between closed-end transactions and sales-based financing, there is still overlap which will create uncertainty as to what disclosures a provider should deliver. This differentiation is important to get right and make sure there is no confusion as the disclosures for sales-based financing include estimated APR and estimate term but closed-end transactions do not. The confusion will revolve around products that have hybrid repayment features where payments are based on sales revenue but there is also a minimum payment component that creates a "term." Many in the industry treat these products as closed-end loans with unique payment features. Because there is an actual term for these transactions, they generally fit within California's definition of a loan. This should not be confused with sales-based financing products with true-up features. These are different as the true-up feature may shorten or lengthen the estimated term of repayment. For these transactions, there is no fixed term that can be calculated until all payments have been made. Therefore, the sales-based financing disclosures are appropriate. However, for loan products with unique payment features that include variable payments but require periodic minimum amounts and therefore have a fixed term, the proposed Regulations should make it clear that these products are closed-end transactions and not sales-based financing products. The definition of "closed-end transaction" appears to address this but in subpart (B) it refers to these transactions as a type of sales-based financing although they are not really sales-based financing transactions (they are just unique loan products).

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

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

(iv) Term (Section 2057(a)(25)) – The definition refers to the length of time it is "anticipated" for the recipient to fulfill its obligations. This wording makes sense for non-loan transactions where there is no actual term. However, for all loan transactions there is a contractual term that governs the relationship and the disclosures provided. The contractual term should be referred to in the definition for these products rather than the "anticipated" term. The two should be the same but the language creates some ambiguity that may create litigation risk for providers. TILA and other state lending disclosure laws are all based on the contractual term and not the anticipated term.

(v) Inventory financing – The term "inventory financing" is used in the proposed Regulations but is not defined. Section 2067 provides formatting requirements for asset-based lending transactions "unless the asset-based lending transaction meets the definition of inventory financing…" This term should be defined.

This regulation violates both the Clarity[4] standard and the Consistency[5] standard of the APA. The regulation is in conflict with other state lending disclosure laws in violation of CA Government Code section 11342.2.

B. General Formatting and Contents[6]

In order to make sure industry participants are providing similar disclosures, we suggest additional requirements be added to specifically address disclosure formatting. The intent of SB 1235 is to provide an apples to apples comparison for small businesses and that requires all disclosures to look similar. Although section 2060 of the proposed Regulations and the product specific sections provide some guidance on the general formatting and content requirements of the disclosures, there are a few items that are not addressed that should be addressed in order for the disclosures to be meaningful. Below are additional requirements we believe would help make the disclosures more meaningful:

(i) The provider should be required to print what type of product is being offered either below/above/or in the same sentence as "Offer Summary." Example: "Offer Summary for Sales Based Financing" or "Offer Summary" and then below that "Sales Based Financing."

[4] CA Government Code section 11349(c)
[5] CA Government Code section 11349(d)
[6] Note that each header for the different types of financing is labeled differently, which make it seem as though each type of financing has different requirements or disclosures (e.g., Closed-End Transaction Formatting and Content Requirements; Commercial Open-End Credit Plan Disclosure Formatting; Factoring Disclosure Format; Sales-Based Financing Disclosure Formatting; Formatting and Content Requirements for Lease Financing; General Asset-Based Lending Transaction Disclosure Formatting; and Disclosure Formatting for All Other Transactions). We suggest making the headings more uniform.

This will ensure that it is clear to the recipient what type of financing is being offered without having to study the wording in the disclosure chart itself. This is critically important as the proposed Regulations require the disclosures be provided long before contractual terms are typically provided. Moreover, if the recipient is receiving multiple disclosures for both a closed-end transaction and sales-based financing, this will assist the recipient in understanding which type of product the disclosures refer to.

(ii) Although the proposed Regulations specify how many rows and columns are to be used, they do not specify whether each cell should be outlined or not. The proposed Regulations permit one provider to create rows and columns with the cells outlined and another could create rows and cells without the outlines. For consistency, the proposed Regulations should be amended to either require or prohibit outlines of the cells in the rows and columns. We believe outlining would be better and more helpful to small businesses (and more consistent with other disclosure laws in the country).

(iii) In conjunction with the outline of the columns and rows, the proposed Regulations do not address any width guidelines. This could result in some providers making the rows and columns very narrow as to extend the disclosure across many pages and make it nearly impossible for the recipient to read. We would suggest guidance on how wide or narrow the rows and columns should be so the disclosures provided by different companies are more similar in appearance.

(iv) There is no specified font size. The concern with this is that some providers could try to make the disclosures smaller or make the text very large so they consume multiple pages (it is less likely a small business will read through multiple pages). A 20 point font would satisfy the "clear and conspicuous" requirement but make the disclosures meaningless as they would take up more than five or ten pages. For consistency, the proposed Regulations should be amended to require a font size range (*e.g.* between 10 point and 14 point font) and that all of the disclosures be required to be in the same font size except the title "Offer Summary" (which could be larger).

(v) The proposed Regulations do not require numerical values (*e.g.*, percentage, date, dollar amounts, etc.) to be disclosed numerically. Accordingly, the proposed Regulations permit some providers to disclose an APR as "26.5%" and other providers to disclose the same APR as "Twenty-Six and One-Half Percent." We suggest the proposed Regulations require that any number, day or dollar amount that must be disclosed be disclosed in numeric value.

(vi) Lastly, the proposed Regulations permit various descriptions to be included with no restrictions. This could lead to descriptions dominating the disclosures and making them ineffective. The descriptions could easily force the disclosures to span ten or more pages (a strategy some providers might use to make it difficult for small businesses to focus on what matters to them).

The above issues are vitally important to address if the disclosures are to be effective. To make this point clear, we have attached a few sample disclosures. The disclosures are all for the same sales-based financing transaction for consistency purposes. The first (Exhibit B) is consistent with how we believe DFPI intends the disclosures to appear. The second (Exhibit C) is an example of a disclosure a provider could give in good faith and still comply with the proposed Regulations. The third (Exhibit D) is a disclosure a provider could give if the intent was to obfuscate the disclosures but still comply with the proposed Regulations. Each of these three disclosures clearly complies with the proposed Regulations but the variances highlight the need for more clarity on the above listed issues.

Additionally, we have the following suggested edits to the current language used in section 2060:

(i) Section 2060(a)(9)(A)[7] refers to the "best information reasonable available." Disclosure laws generally avoid requirements for things such as best available as such words create unneeded litigation risk. Whether something is the best or not is a subjective standard. It would be better to use a phrase that information used in good faith or similar term.

(ii) Section 2060(a)(3) provides that the term is to be disclosed in units of years and months. It is not clear if this would require a six month transaction to be disclosed as "0.6 years, 0 months", "0.5 years", or "0 years and 6 months." This is likely to cause significant confusion. Businesses do not think in terms of half years, a third of a year or the like. Rather they think in terms of months and then years. Accordingly, we suggest for terms of less than one year providers be required to disclose just the number of months (to the nearest

[7] Note that § 2060 has a section (a) but no section (b). It is not consistent with generally accepted outlining rules to include an (a) if there is no (b). It makes it appear as if you forgot the (b). We suggest the (a) be deleted.

two decimal places) or the total number of days. For terms of a year or more, the current wording in the proposed Regulations is sufficient.

(iii) Section 2060(a)(5) requires the disclosure of the APR to the nearest ten basis points. What is a basis point? The phrase is not defined anywhere in the proposed Regulations and can have different meanings. It typically means .01% (1/100th of a percent) but can mean other percentages depending on the context. We suggest you remove the reference to basis point and replace it with one decimal place. However, requiring an APR to be disclosed to one decimal place creates issues as well. TILA does not address the number of decimal places required for the APR as requiring a certain number of decimal places can lead to issues with the tolerance limits (the tolerance limit included in the proposed Regulations is three decimal places (1/8 of a percentage point is .125%)). An APR rounded to one decimal place may be out of tolerance with a .125% tolerance limit. This is exactly why TILA does not require a certain number of decimal places for the APR disclosure and we suggest the proposed Regulations follow the same practice. Note that TILA does address decimal places for the finance charge (dollar amount) but not the APR.

C. Specific Disclosure Forms[8]

A number of the specific disclosure items need further clarification in order for the disclosures to be meaningful. Below are a few substantive comments that must be addressed in order for the disclosures to be accurate and meaningful. Note that we only address these issues in the context of closed-end transactions and sales-based financing transactions as those are the only products we offer as of this date. We suspect similar issues exist for the other transaction types as well. Below is a list of the issues with respect to closed-end transactions and sales-based financing disclosures.

1. Closed-end Transactions (Section 2061)

(i) Row One: Row one column two calls for disclosure of the amount of funds that will be provided to the recipient excluding any deductions. It is unclear if this amount is intended to be a gross loan amount or net loan amount. If you exclude deductions, you are

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[8] Note that various places throughout the proposed Regulations include quotation marks with punctuation inside the quotations and other places where the punctuation is outside the quotations. Compare § 2061(a)(2)(A)("Funding You Will Receive.") to § 2061(a)(3)(A)("Annual Percentage Rate (APR)".). This makes it unclear if you want the punctuation included in the disclosures or not or if it is prohibited in some cases but permitted in other cases. This issue appears broadly throughout the proposed Regulations in violation of the APA Clarity standard.

left with a gross loan amount. However, the wording for column three and the sample disclosures provided in earlier Invitations for Comment lead us to believe you intend for the net proceeds to be disclosed in column two. We strongly oppose disclosing the net amount provided as the first disclosure as it will cause significant confusion and is not how a typical disclosure format works. Even in TILA, the total loan amount is a key disclosure (not buried with other text). It is referred to as the amount financed and there is a separate itemization of the amount financed provided. If the intent of the proposed Regulations is to have the net amount be the main disclosure in column two and the full amount to be in the third column, it will cause mass confusion and make businesses distrust the disclosures and make them less useful. We suggest this section be amended to state the following:

> In the second column, the total amount of funds being borrowed by the recipient (ignoring any deductions such as origination charges and amounts used to pay off other financings).

Note that it was clearly Senator Glazer's intent to have the full loan amount disclosed here as that is what he provided in his sample forms he prepared for the hearings on SB 1235. Including the full loan amount will enable the recipient to quickly identify the legal amount they are borrowing. This amount is the key item to calculate finance charges and APR so it is a critical disclosure to lead with. We are supportive of also disclosing the net amount, whether in column three or as its own new row.

Row one column three calls for a description of how the amount in column two was calculated including amounts and descriptions and amounts of deductions. If column two is the total loan amount, permitting a calculation of how that was arrived to be included permits providers to include long legalese here and that will make the disclosure confusing. We suggest you require that this column has a description of the amount in column two and that it be "the amount of credit provided to you or on your behalf" (assuming total loan amount is what is required to be disclosed in column two). This is the wording TILA uses for the same amount. We agree an itemization is an important disclosure but it should be provided separately from this disclosure box as it will be long, convoluted and confusing. This is why TILA requires the itemization to be provided outside the TILA box.

(ii) Row Two: The formatting and section numbers are incorrect. Under Section 2061(3)(C), there are 4 sub parts - (i) though (iv). However, subparts (i) and (ii) are for the same disclosures (when there is a single fixed, interest rate). The first part of subpart (ii) is actually a continuation of the disclosure for subpart (i). The second part of subpart (ii) is for a different disclosure for when there are multiple pre-determined interest rates that change over time. A similar error occurs in subparts (iii) and (iv) as well. The disclosures need to be segregated and appear in the proper subparts to make sense.

(iii) Row Three: Row three column three requires the provider to include the provider's calculation of the finance charge with an amount and description of each amount. Including calculations and descriptions like these will cause significant confusion and detract from other disclosures. We appreciate the calculations and the fees need some type of description but we suggest you provide specific language for providers to use. TILA does not require the finance charge calculations to be provided. Rather, it simply requires a brief description such as "the dollar amount the credit will cost you." TILA actually prohibits the itemization of the finance charge from being included in the TILA box as such a list of detailed fees and descriptions clearly detracts from the finance charge disclosure itself. *See* Comment 1 to 12 C.F.R. § 1026.18(d). Such calculations can be very detailed and convoluted. Requiring them will just cause confusion.

(iv) Row Five: Row five column three once again calls for an explanation of the term. This could be long and confusing. We suggest you provide form language for this.

(v) Rows Six and Seven: Rows six and seven create material issues. TILA chose to require a simple statement about prepayment penalties as opposed to requiring disclosure of amounts because doing so creates confusion. For example, the proposed Regulations refer to prepayment fees being fees other than accrued interest. What is accrued interest? In an environment such as commercial lending where there is no applicable maximum rate, no rate calculation restrictions or state prepayment requirements, the parties are free to contract when "interest" accrues. In a fixed fee transaction, the contract can clearly state that all fees are earned on day one and therefore accrue immediately upon closing of the transaction. In this scenario, all "interest" has accrued as of the end of day one and there is no prepayment penalty. As such, under the proposed Regulations, a provider could legally disclose that there are no prepayment fees if the contract provides all fees are earned on day one. The recipient is then further misled by the disclosures when the next row (row seven) provides that there are no additional fees for prepayment. In this scenario the disclosures make it appear as if there is a discount for repaying early when there is in fact no such discount. Given this, we believe the better approach with respect to prepayment penalties is to have a more definitive statement about them rather than a calculation and a disclosure amount that can be easily manipulated. We suggest you follow TILA's lead here and simply require the following disclosure: "There is no discount or rebate for paying early" or "Paying off early will save you fees." "Please review your contract carefully to better understand the benefits, if any, of paying off early."

(vi) Alternative Row Four: The disclosure of the monthly cost for a non-monthly pay product does not implement, interpret, or make specific any provision of SB 1235. Requiring this disclosure will not only be inconsistent with SB 1235 but it will do more harm than good. In fact, this disclosure was not mentioned at any of the hearings for SB 1235, was never proposed by Senator Glazer and was never included in any of the model forms Senator Glazer prepared for the hearings and debates on SB 1235. In addition to this disclosure simply not being permitted under SB 1235, adding it would frustrate the purpose of SB 1235 as it detracts from other disclosures that the California Legislature deemed to be more meaningful. It is unclear how disclosing an inapplicable and hypothetical payment amount would be useful information to a recipient. More importantly, the disclosure seems likely to cause confusion given that the information would conflict with the written terms of the commercial financing agreement. We would highly recommend this disclosure be removed as it is not necessary or permitted. Because this regulation is inconsistent with the statute enacted by SB 1235, it violates the APA Consistency standard.[9] The regulation also violates the APA Necessity standard.[10] The regulation is not within the scope of authority granted by SB 1235, in violation of section 11342.1 of the APA. It is not reasonably necessary to effectuate the purpose of the statute, in violation of section 11342.2 of the APA.[11]

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

Additionally, the proposed Regulations require only that the "Average Monthly Cost" be disclosed. How is the average monthly cost calculated? Is the disclosure amount the amount of the monthly cost only (the monthly finance charge) or the total amount to be paid each month (principal and interest)? Monthly cost is not defined in the proposed Regulations. We assume you intend for the total monthly payments to be disclosed and not just the average monthly finance charge but that is not what the current wording requires.

2. Sales-Based Financing (Section 2065)

(i) Row One: Row one column two calls for the disclosure of the amount of funds that will be provided to the recipient excluding any deductions. This creates the same issue as the one mentioned in section (i) above for closed-end transactions. We suggest similar edits be made here to address the issues raised above (with different wording as there is no loan amount or amount borrowed in these transactions).

(ii) Row Four: Row four column two/three states that the provider must disclose the "amount of each estimated periodic payment . . . ." Because all sales-based financings are based on variable payments, as the payments will vary every day based on the card sales or gross revenue of the business, the proposed Regulations appear to require all of the possible periodic payment amounts to be disclosed. We do not believe this is the intent but it is what the current wording requires. We believe the intent was to require the estimated average daily payment amount as calculated using the estimation rules in the proposed Regulations. We suggest you amend this language to avoid confusion and expressly permit sales-based financings that are variable with no true-up mechanism to calculate the payments based on the estimated term and total payback amount and display only one average estimated payment.

(iii) Row Eight: Row eight column two/three discusses prepayments and requires the disclosure of what that prepayment could be. This creates the same issue as the one mentioned in section (iv) above for closed-end transactions. We suggest similar edits be made to this section.

(iv) Alternative Row Four: The disclosure of the monthly cost for a non-monthly pay product is not required or permitted under SB 1235. This creates the same issue as the one mentioned in section (v) above for closed-end transactions. We suggest the similar edits be made here.

D. Estimate – Sales Based Financing (Accounts Receivable Purchase Transactions) – Historical Method (Section 2091)

The section requires a provider to use the same number of months for all transactions to calculate the average monthly sales, income or receipts. It is unclear to us why this "one size fits all" approach is being mandated. If a business wants a longer estimated term (say 18 months), a provider will generally require twelve months of historical statements. This makes logical sense as a full year has different seasonal peaks and valleys in the normal sales cycle. This permits the provider to have a more accurate prediction of sales during the estimated term. However, when a business only wants an estimated term of six months, they do not expect or want to provide 12 months of statements. So the proposed Regulations will put providers in a very difficult spot – require twelve months of statements from all applicants and create significant dissatisfaction with the process or require four months of statements and have materially unreliable projections that may mislead customers (in many cases causing the disclosed Estimated APR to be materially lower than it would have been had twelve months of statements been used). We suggest this issue be resolved in one of two ways. First, require all deals of the same estimated term to have the same number of statements collected and used for projections. Alternatively, permit all transactions with estimated terms of more than six months to be based on twelve months of past statements and all transactions with estimated terms of six months or less to be based on four months of past statements.

Additionally, this section does not expressly address the situation where a provider has asked for the necessary number of statements but the applicant has provided some number less than requested. In many cases, an applicant may simply not want to provide more statements or may not have access to them. The proposed Regulations should be amended to permit for fewer statements to be used in those cases where the provider made a good faith effort to obtain the required number of statements from the recipient but the recipient failed to provide them.

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

E. Annualized Rate Disclosure

Section 3000 simply requires providers to disclose an APR when making a specific offer of commercial financing. This section is unnecessary. APR disclosures are already required in each of the transaction specific form requirements. Is this requirement supposed to somehow be additive? It seems duplicative and unnecessary. If this is some technical requirement given the structure of the applicable law or proposed Regulations, we suggest you add a phrase that this is not an additional disclosure requirement if an APR is disclosed pursuant to another section of the proposed Regulations. The regulation violates the Necessity standard of the APA, and it is not reasonably necessary to effectuate the purpose of the statute.[12]

F. Proposed Disclosures

After review of the proposed Regulations and the intent of SB 1235, we have attached a fourth disclosure (Exhibit E), which includes our proposed edits and what we believe should be disclosed based on the intent of SB 1235. We believe this disclosure is much more streamlined and would prove to be more useful and valuable to small businesses. Furthermore, we believe the disclosure form actually comports with the intent of the proposed Regulations and eliminates issues caused by the confusing wording and the provisions inconsistent with typical disclosure laws such as TILA.

G. Calculation of Annual Percentage Rate

As we have argued in the other submissions we have provided on this topic (see Exhibit A), we do not believe APR is the best metric and will actually cause more confusion. We incorporate our prior comments provided to you into this letter. However, given you have decided to proceed with APR, we have the following comments on this section.

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

1. It does not address amendments. If Appendix J is amended, are providers to ignore any such amendments and follow the language that exists as of December 30, 2011? It seems this section should incorporate amendments after December 30, 2011.

[12] CA Government Code § 11349(a)

2. Part 1026 specifically covers only closed-end transactions. It does not apply to open-end transactions. This is a material problem as the proposed Regulations will require open-end products to use TILA closed-end calculations. Considering TILA has specific calculations for open-end credit, we suggest the APR for open-end products be calculated in accordance with the open-end sections of TILA (*See* 12 C.F.R. § 1026.14).

Section 3001(b) provides that the disclosed APR shall be deemed accurate if it is not more than 1/8 of 1 percentage point above or below the properly calculated APR. The "above or below" wording is taken from TILA and has been the cause of significant litigation in the past. If an APR is overstated, there is no harm and there should be no damages. This has been the conclusion most courts have reached under TILA after decades of litigation. In order to avoid the same needless litigation, we suggest this wording be amended to provide that a disclosed APR is accurate if it is not more than 1/8 of 1 percentage point below the properly calculated APR. Even an APR overstated by 10% should not lead to litigation as the recipient has suffered no harm. The regulation violates both the APA Clarity[13] standard and is not reasonably necessary to effectuate the purpose of the statute.[14]

Section 3001(d) provides that when calculating the APR, the provider can assume it can collect payments every calendar day even if it cannot do so. Additionally, section 2060(a)(4) requires providers to assume 30 days in each month. These two required assumptions will lead to APRs that are not accurate as there are many holidays and weekends in repayment terms. Accordingly, these assumptions will lead to different APRs than what would be calculated under TILA as TILA does not permit such broad assumptions. While 12 C.F.R. § 1026.17(c)(3) permits most creditors to ignore certain items when making calculations, it does not permit repayment terms to be based on payments being made every day. Consider the impact of these assumptions in connection with a nine month daily pay product. Nine months is about 270 days. However, if a provider only collects payments on business days, there would be 198 payments (assumes 22 business days in each month). That means the proposed Regulations effectively manufacture out of thin air 72 additional payments (270-198=72). That is 26% of the 270 day term. It is a material

[13] CA Government Code § 11349(c)
[14] CA Government Code § 11349(a)

amount and will cause variances in APR calculations (in many cases outside the tolerance limits). This will also cause confusion if recipients attempt to calculate their own APR. The periodic payment disclosure is calculated based on actual payments made per business day (on average about 22 payments per month) but the APR is calculated based on 30 payments being made each month. So the required disclosures will disclose a periodic payment amount that is higher than the periodic payment amount used to calculate the APR. It is simply unheard of in disclosure laws to create such conflicting disclosures and deceive applicants as to the cost of the product being requested. The regulation violates both the Consistency[15] and the Clarity[16] standards of the APA.

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

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

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

[15] CA Government Code § 11349(d)
[16] CA Government Code § 11349(c)

i. A state law that requires use of the term finance charge, but defines the term to include fees that the Federal law excludes.

ii. A state law that requires a label such as nominal annual interest rate to be used for what the Federal law calls the annual percentage rate.

The proposed Regulations do precisely this. The proposed Regulations mandate use of APR but then change how APR is calculated, create new disclosures and APR calculations called estimated annual percentage rate (if a phrase such as nominal annual interest rate is preempted by Regulation Z, clearly the phrase estimated annual percentage rate is preempted) and requires closed-end calculations for open-end transactions. APR and finance charge are terms of art created by TILA and Congress wanted the terms to be protected so that the disclosures would not lose meaning by States redefining them and then using the same terms in other contexts. While TILA applies mostly to consumer credit transactions the preemption provisions are not limited to just consumer credit transactions. Rather, the provisions of TILA addressing preemption with respect to APR and finance charge are not limited to consumer credit transactions. *See* 15 U.S.C. § 1610(a)(1). It should be noted that when TILA or Regulation Z intend for the preemption rules to be limited only to consumer credit transactions, they expressly state so. For example, Comment 2 to 12 C.F.R. § 1026.28(d) provides that preemption for credit card and charge card rules applies only to consumer transactions and not to business transactions. There is no such limiting language for preemption of inconsistent APR and finance charge disclosures required by State law. The regulation violates the APA Consistency standard.[17]

H. Duties of Financers and Brokers

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

[17] CA Government Code § 11349(d)

provider, a provider should be provided with a waiver of liability if the broker fraudulently creates the transmission or alters it in anyway. The regulation violates the Clarity standard of the APA.[18]

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

III. CONCLUSION

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

Very truly yours,

[redacted]

Joseph D. Looney
General Counsel

[18] CA Government Code § 11349(c)

EXHIBIT A

EXHIBIT A

Submitted by Electronic mail to: regulations@dbo.ca.gov and [redacted]@dbo.ca.gov

Department of Business Oversight, Legal Division
Attn: Mark Dyer, Regulations Coordinator
1515 K Street, Suite 200
Sacramento, CA 95814-4052

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

Dear Commissioner Owen,

Small Business Financial Services, LLC dba RapidAdvance ("RapidAdvance") would like to thank the Department of Business Oversight ("DBO") for reaching out to stakeholders and inviting them to provide input on the above referenced rulemaking. RapidAdvance appreciates that the DBO invited industry participants ("Providers") to submit their thoughts and comments.

In this letter, we address each of the topics and questions you list in your Invitation. However, before doing so, we thought it would be helpful to address some broad topics about RapidAdvance and the industry and to also comment on the evolution of the use of the Annual Percentage Rate ("APR") in financing disclosures.

I. OVERVIEW

RapidAdvance provides working capital to small businesses throughout the United States and operates as a licensed Finance Lender in California. RapidAdvance and its affiliates have been providing funding to small businesses for more than a decade and many of our customers have grown to become thriving businesses. Our financing products include merchant cash advances ("MCAs") and business loans. MCAs allow small retail businesses to sell their future card sales in exchange for immediate working capital (the transaction is a purchase and sale rather than a loan).[1] Our small business loan is similar to a traditional commercial loan with two primary

[1] Note that this is the only MCA product offered by RapidAdvance (*e.g.* a purchase of a percent of a business' daily credit card receivables) and we refer to this as a traditional MCA. Others in the industry offer another MCA product in which a percent of the business' daily gross revenue is purchased and we refer to this as a gross revenue MCA. In both cases, the Provider is purchasing a revenue stream similar to traditional factoring transactions (traditional factors purchase payment obligations owed by customers to the business and traditional MCAs purchase payment obligations owed by card acquiring banks to the business).

differences. First, the borrower makes payments on a daily or weekly basis rather than monthly. Second, our loans charge a fixed fee rather than an interest rate. A fixed fee allows our customers to easily determine the actual dollar amount the loan will cost and the more frequent payment schedule ensures the business is not overwhelmed by large monthly payments. Our underwriting model allows us to fund businesses that traditional lenders turn away and permits us to offer financing solutions to businesses whose growth is constrained by their ability to access capital.

The customers that use our financing products include almost every type of small and medium sized business in America. Our customers' annual revenue generally ranges from $250,000 to $4,000,000. The average funding we provide is about $50,000. Approximately 90% of our customers are limited liability companies or corporations. The online small business finance industry now originates more than $15 billion annually and the overwhelming majority of small businesses that have obtained financing from industry participants prefer our products and process over traditional financing sources.

In connection with SB 1235, there has been much discussion about the need for mandatory cost disclosures with the core of the debate centering on an annualized rate disclosure. Basic requirements of contract law require that financing companies disclose the funds the business will receive (total amount of funds provided); what they will pay back (not required in SB 1235 but clearly should be added); method, frequency and amount of payments; the prepayment policy; and for products with a term, the duration. All of these terms are required in order for the financing contract to be enforceable. Without these terms being agreed to in writing between the Provider and small business, the Provider would not be able to enforce the terms under basic contract law. Moreover, if Providers fail to provide these disclosures, it would be difficult for them to obtain customers as these are the core terms small business owners use to negotiate financing arrangements. So while there may be some debate about the details of these disclosures and the format in which they are provided, every industry participant is in agreement that these are the core terms that businesses expect to see when applying for financing. In fact, this was exactly what occurred when SB 1235 was being drafted – most industry participants agreed these terms were valuable, helpful and necessary. Creating uniformity around how these terms are communicated will help businesses compare products and enable them to make faster and informed decisions.

The disclosure item that caused the most debate during the enactment of SB 1235 was the annualized rate metric. The original version of the bill included APR, but then a revised version replaced APR with Annualized Cost of Capital ("ACC") and the final bill simply requests the DBO to determine the appropriate annualized rate disclosure. During the legislative process and at the DBO's introductory meeting on November 29, 2018, some erroneous statements were made by industry participants indicating a high degree of confusion and misinformation regarding the value of APR disclosures. In order to make a reasonable determination as to whether APR should be the annualized rate metric used, we believe the evolution of APR disclosures should be understood. SB 1235 is the first law in the country that requires cost disclosures for small business financing products and may serve as a model for other states to adopt similar laws. Accordingly, we do not think disclosure metrics should be adopted simply based on anecdotal evidence of what may or may not be helpful to small businesses. Rather, we believe DBO should thoroughly investigate which annualized disclosure provides the most value to small businesses, is easily understood and assists in comparison shopping. Importantly, that investigation should include input from randomly selected small business owners who have actually used these products to grow and manage their business finances. Thus far very little of the discussion has been driven by small business owners who have obtained our products. Rather, it has been driven by various groups of capital providers, with the lower cost providers arguing for more disclosure and the higher cost providers arguing for less disclosure.

II. ANNUAL PERCENTAGE RATE

The APR is a measure of the cost of credit created by Congress as part of the adoption of the Truth in Lending Act ("TILA") in 1968. It was created for the specific purpose of helping consumers compare the cost of credit for lending products with different terms. It was not intended to apply to commercial loans and the APR calculation by definition is limited only to consumer transactions. When the APR was first adopted in 1968, there was a debate about whether it should apply to commercial transactions. Congress concluded it should not and this view has not changed since 1968. Since the original creation of APR, Congress and the applicable federal regulators have often considered whether TILA and/or the APR disclosures should be expanded to apply to commercial transactions but they have refused to do so. Most recently, in 2010 the Federal Reserve Board studied this issue and concluded that TILA's disclosure provisions should not be expanded to apply to small business credit cards as it was not clear if the benefits would outweigh the costs.

Not only have the applicable federal regulators refused to expand the use of APR to small business financing, they have reduced the importance of APR in consumer transactions and in some cases stopped requiring certain APR disclosures for consumer transactions. For example, in 2009, the Federal Reserve Board ("Board") underwent a review of the credit card disclosure rules (or the open-end, non-mortgage disclosure rules) required under TILA (74 Fed. Reg. 5244 (Jan. 29, 2009)). After extensive consumer testing related to credit cost disclosures, the Board adopted new disclosure requirements that eliminated the effective APR as a measure of cost of credit for unsecured open-end credit due to the confusion consumers exhibited when asked to explain what it meant. Before those rules became effective, Congress enacted additional substantive protections for credit card accounts (referred to as the CARD Act) and in adopting rules to implement those new statutory protections, the Board <u>*readopted*</u> the rules that eliminated the effective APR. They replaced the effective APR disclosure with an annualized simple rate and a separate dollar disclosure of fees. In adopting this rule, the Board rejected numerous comments from consumer advocates arguing that the effective APR was a critical disclosure for consumers to understand the cost of credit. In rejecting the consumer advocates' arguments to maintain the effective APR, the Board stated, "Most consumers do not understand the effective APR, and that for some consumers the effective APR is confusing and detracts from the effectiveness of other disclosures." It should be noted that when the Board started this review, it specifically contemplated two possible approaches. First, was to spend resources to educate consumers so they better understand the effective APR and to help creditors to better understand how to calculate the APR. Second, was to remove the effective APR disclosure all together. (*See:* 72 Fed. Reg. 32955 (June 14, 2007). In choosing to proceed with the second option, the Board determined that an annualized rate disclosure that included all fees was not valuable to consumers. Prior to this, in an open-end credit product (such as a credit card), TILA required two types of APR disclosures – the corresponding APR and the effective APR. The corresponding APR simply discloses the rate that *will be* assessed and does not include fees and other charges (functionally equivalent to a simple interest rate disclosure). The effective APR was a disclosure required each month that reflected the actual rate *that was* assessed on the outstanding balance for that month and included all finance charge fees imposed that month (it was the total cost of the plan for that month as it included all fixed finance charge fees assessed that month as well as all fees imposed as a result of the application of a periodic rate or interest rate). The corresponding APR was always lower than the effective APR anytime the open-end plan was used and any finance charge fees were imposed. Consumer advocates argued that the effective APR was the true representation of the cost of the credit and must remain as a required disclosure so that consumers can better compare credit and understand the true costs of credit. The view of consumer advocates was that the corresponding APR was insufficient as it did not include fees, was merely a projection of what the simple interest rate would be and did not reflect the true cost of credit charged for any applicable month (they wanted the higher rate (effective APR) to be disclosed and not the lower rate (corresponding APR)). The Board rejected these arguments and made disclosure of the effective APR optional. This decision permitted credit card issuers to disclose only a corresponding APR (a lower APR that according to consumer advocates did not reflect the actual cost of credit). So in effect, the Board concluded that with respect to credit cards the interest rate disclosure has some value to consumers but the APR as traditionally thought of (inclusive of fees) does not.

Despite the focus group studies and overwhelming research concluding that the APR is confusing and detracts from other disclosures, consumer advocates continued to argue that APR is the most important cost disclosure for consumers when comparing credit. However, the federal regulators continue to reject this premise based on the results of additional studies. In 2013, the Consumer Financial Protection Bureau ("CFPB") conducted what is believed to be the largest study ever done on the topic in connection with the issuance of its Integrated Mortgage Disclosure rules (78 Fed. Reg. 79730 (Dec. 31, 2013)). The results of the study led the CFPB to conclude that the APR is not used by most consumers and is confusing. As a result, when the new disclosures were adopted for mortgage lending (commonly referred to as TRID), the CFPB decided to move the APR disclosure to the back of the disclosure forms and make it less conspicuous. This move was significant as TILA has always required the APR to be more clear and conspicuous than other disclosures and the CFPB used its authority to simply change this with no Congressional action. In doing so, the CFPB stated, ". . . consumer testing and historical research indicate that consumers do not understand the APR and do not use it when shopping for a loan. Highlighting the APR on the disclosure form contributes to overall consumer confusion and information overload, complicates the mortgage lending process, and hinders consumers' ability to understand important loan terms."

The conclusion by the CFPB makes it clear that APR has much less value than advocates claim. Various quotes by the CFPB throughout the TRID rulemaking process make it clear beyond dispute that the APR is confusing, is not used by consumers to compare products (at least in the mortgage industry) and has limited usefulness. Below is a list of various quotes by the CFPB taken directly from the rulemaking for the TRID disclosures:

> "[T]he APR is limited in its usefulness as a measure of the cost of credit."
>
> "Prior studies conducted by other Federal agencies as well as consumer testing conducted by the [CFPB], however, indicate that consumers do not really understand . . . APR . . . ."
>
> "[C]oncerns have been raised repeatedly over the last two decades that consumers are confused by what the APR represents and do not use it for its intended purpose: to compare loans."
>
> "[The CFPB's] consumer testing similarly indicates consumer confusion regarding the APR disclosure and that consumers do not use the APR when comparing loans."
>
> "[I]n light of consumer confusion over the APR and the fact that consumers do not appear to use the APR in comparing loan offers, the [CFPB removed the requirement] that the annual percentage rate disclosure be more conspicuous than other disclosures . . . ."
>
> "[C]onsumer testing conducted by the [Federal Reserve Board and CFPB], and comments received by the [CFPB] consistently indicate consumer confusion over the APR."

Given that the express purpose of creating the APR was to assist consumers in comparing the costs of credit, the fact that the CFPB has concluded that the APR is not used for that purpose is a material finding. In fact, even Congress recognizes the APR is insufficient and does not serve its intended purpose. The Dodd-Frank Act amended TILA to require a new rate disclosure - the Total Interest Percentage ("TIP"), which is simply the total amount of interest that the consumer will pay over the life of the loan expressed as a percentage (*e.g.,* a $100,000 mortgage loan with $50,000 of interest over the life of the loan would have a TIP of 50%). *See* Dodd-Frank Wall Street Reform and Consumer Protection Act sec. 1419(19). The CFPB issued implementing regulations for this new rate disclosure as part of the TRID rules. The TIP disclosure is an attempt to provide information to consumers that is more useful than APR, easier to understand and easier for creditors to calculate.

Potentially causing further confusion as to the use and/or reliability of the APR, the CFPB is also considering amending the manner in which the APR is calculated for mortgage loans by changing what types of fees are included in the definition of finance charge. The goal is to make APR easier to understand and easier to calculate. The CFPB considered doing this as part of the TRID rules but did not proceed given the magnitude of such a change. However, the CFPB did state it plans to study the issue and address changes to the APR calculation and finance charge definition when it reviews the TRID rules in the next 2-3 years.

With the above factual record explaining the shortcomings of APR and the fact APR is not used to compare the cost of credit, it is possible to better respond to the various inaccurate statements made by those arguing APR is the only annualized disclosure that should be considered for small business financing products. Below are the two key arguments that were made by advocates of APR in connection with SB 1235 followed by a brief response for each:

1. Small businesses use credit cards and mortgages to finance their businesses and will use the APR to compare those products with other small business financing options.

   As explained above, credit cards no longer require a true APR disclosure (only an APR disclosure that is equivalent to a simple interest rate is required). Accordingly, the comparison of a credit card APR to a closed-end commercial loan APR (assuming it is adopted from the TILA closed-end APR rules) will simply cause even more confusion as the two APRs will not be calculated the same (it will not be an apples to apples comparison as the required open-end APR disclosure does not include non-rate fees but the required closed-end APR does). Also as explained above, the APR for mortgage loans has been moved to the back page of disclosures, made less conspicuous and has been complimented with a new rate disclosure – the TIP. However, even more important is the fact the CFPB has concluded that consumers simply do not use the APR for comparison shopping. Therefore, there is simply no evidence that small business owners want or will use APR to compare credit cards, mortgages and small business loans when considering how to finance their businesses. This fact and the confusion surrounding the usefulness of the APR makes it clear that there is limited value in requiring APR disclosures for commercial financing products. In fact, based on the studies commissioned by of the Federal Reserve Board and the CFPB, requiring an APR disclosure is certain to create confusion in the small business financing marketplace.

2. Creating a new disclosure like Annualized Cost of Capital ("ACC") will be confusing.

   The counterpoint to this argument is that the APR itself is confusing. Adopting a new rate disclosure would be a good thing given that APR is not used for comparison purposes and is confusing. This is the exact reason Congress required TIP – a new rate disclosure for mortgages that was easier to understand and calculate than APR. The ACC is in fact simply a version of TIP (uses the same basic math (total fees/interest divided by principal) but then annualizes the rate, which TIP does not do).

When researching the annualized rate issue and deciding what rate disclosure should be required, we would also suggest DBO consider these additional broad issues:

1. Requiring any accruing rate disclosure (like simple interest rate or APR) for fixed fee loan products or non-loan products (MCAs, factoring, etc.) will be misleading as the fixed fee loan products have no accruing rate. A fixed cost product that is not paid back during the originally agreed upon or estimated term, does not continue to accrue fees or charges. So the longer it takes to pay back, the cheaper the transaction becomes (unlike a traditional loan where an accruing rate is charged for as long as a balance is outstanding). Disclosing a rate for fixed cost products will simply cause the customer to incorrectly believe a rate is applied to a balance and will be applied for as long as any balance is outstanding.

2. APR is a complicated mathematical calculation. APR is a mathematical calculation under TILA that has various elements and is calculated differently for open end loans, mortgage loans and closed end loans. The rules for its calculation are very specific and take up numerous pages in the Code of Federal Regulations. Given the mathematical precision required for the formula, it is very difficult to calculate for most products. While many people will refer to an APR as being easy to calculate and can be done using a spreadsheet, that is simply not true. Typically, those who do this are calculating a rate of return or simple interest yield and not the much more complicated APR. In fact, various APR calculators produce conflicting results for anything other than the standard fixed rate, closed end, monthly payment products. These calculators fail to account for the nuances in the APR calculation and the complications created by variable payment, variable rate or variable term products. These problems are material in the consumer loan industry as a disclosed rate that varies by more than .5% can create significant liability for lenders based on the limited tolerance levels permitted under TILA for misstated APRs.

3. APR or an annualized rate similar to APR will be even more confusing in the business financing industry as payment terms are so unique. APR can be misleading for many of the more innovative products that provide more frequent payments or unique repayment features. For example, two products with identical pricing and terms will have different APRs if one is a monthly pay product and one is a daily pay product. In fact, a monthly product can be materially more expensive on a dollar basis than a daily pay product but still have a lower APR. This can lead a small business to believe a product is cheaper when in fact the product is more expensive. (See Appendix A for examples of comparison of daily and monthly pay product APRs).

4. While there are numerous differences between consumer financing transactions and commercial financing transactions, the main difference is the underlying purpose. Consumers obtain financing to purchase items for lifestyle needs or desires. Small businesses obtain financing to grow their business and make more money. So for small business financing transactions the total dollar cost is the most important disclosure as

that can be compared to the expected business benefit to calculate the monetary return to the business. If a small business can obtain financing and the cost is $3,000 but they can use the money to make $9,000 in additional profit that is what is most important. Creating any disclosure regime that may make it harder to understand the actual dollar cost of a financing transaction should be avoided. Requiring an annualized rate disclosure that is more conspicuous than the total dollar cost will simply hurt small businesses and frustrate the purpose of SB 1235. Also, requiring a rate disclosure that makes a product appear less expensive compared to another product when in fact the dollar cost of that product is more expensive will cause confusion (see Appendix A for an example of how this could occur).

5. If the DBO adopts an annualized metric that accounts for the declining balance (like APR does), the rate calculations must address how to handle daily payment transactions and variable payment transactions. However, TILA and its implementing regulations never envisioned daily pay products and do not provide guidance on how to address the issues created by these types of products. Daily payment transactions create issues for such calculations as payments may or may not be required on weekends or holidays. Current APR guidance under TILA does not expressly address how to handle the unique issues raised by variable amount and daily payment transactions. For example, a transaction with the exact same terms originated on different dates may have different APRs as the number of weekends and/or holidays may be different based on the origination date of each transaction. This issue is further complicated as different Providers make different payment assumptions (some assume there are 20 payment days each month and some assume there are 22 payment days each month). A further complication is presented by the fact that a Provider may assume payments do not even occur every business day (might assume every other day or only 15 varying days per month). All of these issues must be addressed by specific guidance if APR is the required disclosure given the mathematical certainty required by the APR.

6. Requiring an annualized rate disclosure typically used for loans (like simple interest rate or APR) to be used for non-loan products (MCAs, factoring, etc.) will create massive confusion. For variable payment products such as MCAs, Providers must disclose the percentage rate of the daily receivables the small business must deliver to the Provider each day. In order for the agreement to be enforceable under basic contract law, that rate must be included in the contract. If an APR or similar rate is also required to be disclosed, small business owners will be confused. For the percentage rate of daily receivables, the disclosure might be 9% but the APR might be 40%. The small business will be confused as to which rate reflects the cost of the financing and in the end will simply ignore both of them (which the CFPB acknowledges has happened in the mortgage industry – APRs are simply ignored by most consumers).

7. The above issues are made more complicated given annualize rate disclosures have never been imposed on consumer purchase and sale transactions. It is impossible to calculate even an implied rate for purchase and sale transactions because there is no fixed term or accruing rate. Because purchase transactions do not require specific amounts to be paid at a designated frequency, the term for these products cannot be calculated until after the transaction has concluded. Without a known term, only an estimated term and rate can be provided, which means the annualized rate and term disclosed will be, by definition, incorrect and misleading. For this reason, no state or federal law has ever required an annualized rate disclosure for these products – consumer or commercial. For example, TILA does not apply to purchase and sale transactions with consumers. Rather, it applies only to loans, lines of credit and retail installment financing. Accordingly, TILA does not apply to transactions with consumers when they sell something for a lump sum such as lottery winnings, inheritance proceeds, litigation proceeds, etc. APR or other rate disclosures are not required in any of these transactions because implying a rate disclosure on a purchase transaction is confusing and unwarranted. For these types of consumer transactions, many states have taken action and provided their own disclosure regimes that do not artificially treat purchase transactions as loans but recognize them for what they are under the law and require appropriate disclosures. *See e.g.*, Cal. Prob. Code sec. 11604.5 (law regulating the sale of inheritance proceeds where no rate is required but other disclosures are required). Even the federal Equal Credit Opportunity Act respects the distinction between financing transactions and purchase and sale transactions. *See* 12 CFR 1002.9(a)(3) – Comment 3 ("Factoring refers to purchase of accounts receivable, and thus is not subject to [ECOA or regulation B]."

8. Given the fact that APR is confusing and not used for comparison shopping and that purchase and sale transactions do not have rates or terms, we believe the DBO should adopt a new rate and not use APR. If a rate is required for commercial financing products, the required rate must be easier to calculate than APR and be less confusing than APR. We believe the ACC is a good starting point. A rate more easily understood and calculated is preferable to APR as it will make comparison shopping easier and will be more likely to be used for its intended purpose – to compare product costs.

We are happy to meet with the DBO to discuss the above issues in an effort to formulate a resolution. Our current thought is the best thing to do is to design some disclosure forms and then work with a research firm, preferably one that is familiar with the issues discussed above, to conduct testing and statistically determine what form and disclosures make the most sense to small businesses. Whenever federal regulators impose new disclosure requirements, they complete a study to make sure the required disclosures make sense and serve the intended purpose. More often than not, the federal regulators use Kleimann Communications Group, Inc. When the CFPB undertook the redesign of mortgage disclosures as part of the TRID rules, they noted that Kleimann has been hired by numerous other Federal agencies to perform similar design and qualitative testing work in connection with other financial disclosure forms (*e.g.* the FTC and bank agencies for model privacy disclosures and HUD for RESPA disclosures).

Thank you for permitting us to summarize some of the history of APR and to explain the broad issues raised by APR as well as outline much of the misinformation that has been used to argue APR should be used as part of SB 1235. Below we move on to address the specific questions raised in your Invitation.

III. INVITATION REQUESTS

A. <u>Definitions</u>

We believe a disclosure should be added for the total payback amount, which then would require the phrase to be defined. Of all the numerical values SB 1235 requires to be disclosed, it fails to require disclosure of arguably the most important amount – the total payback amount. This amount tells the customer what their total legal obligation is and also permits them to verify the other calculations. Without this disclosure, it is impossible to confirm the other items are properly calculated. In fact, for consumer transactions, the payback amount (called the "Total of Payments" under TILA and described as the amount the customer will have paid when they have made all scheduled payments.") is one of the key disclosures.

We also believe the following definitions provided in SB1235 are incomplete and should be clarified:

1. 22800(a) and (k) "Account" and "Payment Intangible" – These terms are terms of art under the Uniform Commercial Code ("UCC"). The UCC has extensive commentary and a long history of case law addressing these definitions. We suggest these definitions be amended to simply incorporate the relevant provisions from the UCC in order to gain the clarity from the UCC commentary and the long history of case law addressing these terms.

2. 22800(c) "Asset Based Lending Transaction" – This definition is contrary to the common usage of this phase. Asset based lending is almost universally used to describe a transaction where a lender loans money to a borrower based on the value of an asset or assets of the borrower. In the consumer world, mortgages and auto loans are common asset based lending transactions. In the small business world, asset based loans are often based on inventory or other assets. The key element for an asset based loan is simply that there is some asset that the lender loans against and expects to repossess if the borrower defaults. However, the definition in SB 1235 applies only to "transaction[s] in which

advances are made from time to time contingent on a recipient forwarding payments received from one or more third parties . . . ." In fact, many asset based lending transactions have nothing to with payments being received from third parties. It appears this definition is confusing asset based lending transactions and traditional factoring transactions. In traditional factoring transactions, payments are received by third parties but there is often no asset securing the transactions. Virtually every factoring transaction is a purchase and sale and is not a lending transaction so even the title to the definition (asset based lending transaction) will create confusion. We suggest any regulations clarify these mistakes and make it clear as to what transactions are covered. Because SB 1235 is intended to cover all type of transactions that provide financing to small businesses, it would be clearer just to provide a generic definition for all such transactions and not define each sub-type of transaction (the specific sub type definitions serve no material purpose in the disclosure requirements so the distinctions are largely irrelevant).

3. 22800(m) "Provider" – Our suggestion is to make the definition of a bank partnership model not as rigid so that various types of bank partnership models are covered. Banks are very flexible in structuring partnerships so the regulatory definition should be broad enough to capture current and future models.

4. 22800(n) "Recipient" – The definition's use of the word "presented" creates ambiguity. It is not clear what is meant by "presented" and there is no guidance on whether the disclosure requirements are triggered whenever they are "presented" or only when they are "presented to the small business customer" (it is not uncommon for offers to be "presented" to brokers first). It would be helpful to clarify that the recipient is the person who requested the commercial financing for itself and clearly explain when terms are presented so as to trigger the disclosure requirement.

B. <u>Commercial Financing Requiring Estimated Term Disclosures</u>

Any commercial financing agreement that is not a loan, line of credit or lease does not generally have a term. All purchase and sale transactions have no term as the purchaser is simply purchasing the right to a revenue stream whenever that stream may occur. So transactions such as factoring transactions have no fixed term as they do not create an absolute obligation to repay a sum certain according to a specific schedule. Transactions that typically fit into this category are purchasing of invoices or accounts payables (traditional factoring); traditional merchant cash advances (these are simply a newer form of traditional factoring where the purchaser is purchasing a portion of the revenue stream owed to the small business by the acquiring bank (the amount owed to the business by the acquiring bank is generally viewed as a payment intangible)); or the purchase of a portion of gross revenue (which is simply the purchase of a portion of the business' total payment stream). Since these transactions are purchase and sale transactions, the buyer is taking the risk of non-payment as well as the risk that payments will be made over an extended time period. Accordingly, there is no term for these products to be disclosed. Regulations could compel purchasers to disclose an assumed or estimated term when setting the price but that creates material issues as the business customers may view any estimated term as an actual term and not realize certain rights they may have given it is a purchase and sale transaction. Accordingly, if an estimated term disclosure is required it should be accompanied with a disclaimer explaining there is no term for these types of transactions and that the actual term will differ.

C. Disclosure of Method, Frequency, and Amount of Payments for Commercial Financing with Flexible or Contingent Repayment Obligations

The method, frequency, and amount of payments should be displayed as stated in 22803(a). There should also be additional disclosure information explaining how the method, frequency, and amount of payments are determined so that the recipient can understand the items. Providers should be required to include an explanation next to or with the disclosures and we suggest the regulations mandate what that language be so it is uniform for each type of repayment option.

D. Annualized Rate Disclosure

As explained above in section II, the APR is a cost disclosure that was created by the federal government and modified over the last 50 years in an effort to provide a clear cost comparison tool to consumers. However, as described in Section II herein, it is clear that the APR is not accomplishing its intended goal. It is confusing to the vast majority of consumers, is ignored for comparison shopping purposes and creates material risk for creditors given it is so complicated to calculate. For these reasons, federal regulators have stopped requiring a true APR disclosure for credit cards (as the changes made by the CARD Act require that card issuers disclose only a corresponding APR, which more similar to a simple interest rate) and mortgage disclosures have now moved the APR to the back page as consumer testing found it caused too much confusion, was not used for comparison shopping and detracted from other disclosures. Despite the constant drum beat from consumer advocates that the APR is the most important disclosure consumers have when comparing the cost of credit, federal regulators have failed to confirm this assumption after extensive testing and research. In fact, the testing and research show the opposite – the APR is not useful and confuses consumers.

As part of SB 1235's enactment, various parties argued that the APR should apply to commercial financing even though it was never intended to apply to that type of transaction. Moreover, federal regulators have concluded that the costs of requiring APRs for commercial transactions outweigh the benefits (the costs being confusion, reduction of credit made available to small business owners due to risks associated with APR, etc.). APR is simply a mathematical formula and like all mathematical calculations may be changed and improved over time to arrive at simpler calculation methods that achieve better results.

During the process of drafting SB 1235, RapidAdvance worked with the bill's author to devise an alternative to APR that would be easier to understand and easier to calculate. That calculation became known as the Annualized Cost of Capital or ACC. The ACC is simply a form of the APR calculation that ignores the impact of the declining balance on the rate calculation. We found this proposal helpful for the following reasons:

1. APR requires complicated math and the complications become exponentially harder as more payments are required during the term or when daily payments may fluctuate in amount for certain products. For daily payment products and variable payment products, the math required to properly calculate an accurate APR is extremely difficult. These types of products did not exist when the APR was initially adopted and these types of payments are still not used in the consumer lending industry so there is no guidance on how to handle the unique issues created by these products.

2. The APR has always been synonymous with lending products. Given SB 1235 requires a rate disclosure for lending products and non-lending products (like purchase transactions) it will cause less confusion if a new metric is developed that is not viewed as a lending only disclosure.

3. While we appreciate that the creation of a new rate disclosure may cause some confusion, that risk must be weighed against the fact that we *know* APR causes confusion. Trying to offer a better solution is a more reasonable path in our view than simply continuing to use APR - a rate disclosure most people do not use to compare costs and that has repeatedly been proven to be confusing. Additionally, ACC had its genesis in federal legislation that created the Total Interest Percentage disclosure for mortgage transactions (commonly referred to as the TIP). The TIP is basically the same calculation as the ACC but the ACC annualizes the cost while the TIP does not. The fact that the federal government just created this new cost disclosure for mortgages (the most significant financial transaction for most consumers), should encourage the DBO to adopt a new rate disclosure that makes more sense than APR and will do more to assist business owners in comparing costs.

4. The ACC enables small businesses to focus on the true dollar cost of the transaction and not let the rate disclosure be artificially influenced by payment frequency (which is already required to be disclosed elsewhere in SB 1235). By requiring payments to be made less frequently, a lender can make the cost of a transaction appear lower (showing a lower APR) but the dollar cost may actually be higher. The ACC avoids this issue and prevents lower rates with higher dollar costs based solely on payment frequency (see Appendix A for examples of the impact of payment frequency on APR and how ACC is a more consistent and reliable measure of the costs of credit).

Beyond doubt, the adoption of APR will cause confusion and frustrate the purpose of SB 1235 (*e.g.* to enable small businesses to compare the costs of different financing products). Whatever rate the DBO adopts must address the following issues:

1. Be easy to understand and calculate.
2. Be a rate that is unique from APR as APR is a rate used for lending transactions and SB 1235 applies equally to lending and non-lending transactions.
3. Be a rate that is not easily manipulated based on payment frequency.

4. Be a rate that is not capable of being confused with a daily percentage or specific amount for transactions where payments are a percent of a business's daily revenue or certain receivables (showing a 9% Daily Percentage next to a 14% APR will simply cause even more confusion than has been proven to exist in consumer mortgage transaction).
5. Be a rate that does not imply that the rate is accruing on the outstanding balance as many transactions subject to SB 1235 do not have an accruing rate and the longer they take to repay the cheaper the transaction becomes.

We believe the ACC addresses these issues and encourage the DBO to adopt ACC or a similar annualized rate. Whatever rate the DBO adopts, we would suggest the DBO create an online calculator that Providers can use to calculate the rate so it is clear that every Provider is using the same mathematical formula. The regulations should provide that the use of such a calculator would create a safe harbor for Providers so Providers are not liable for miscalculations caused by the calculator. Moreover, an online calculator would be beneficial for the small business as many would prefer to calculate the rate themselves to ensure what is being presented in the disclosures is accurate is consistent with their understanding or assumptions.

E. Types of Commercial Financing

The below are examples of commercial financing transactions that are not fixed-rate, fixed-payment financing:

- Merchant cash advance
- Open-end commercial loans and lines of credit
- Traditional factoring
- Equipment leasing

These transactions all present unique challenges with respect to SB 1235 as they are not fixed rate monthly payment loan products. Accordingly, the repayment features are different, legal structure is different and the consequences of requiring consumer oriented loan cost disclosures are different. SB 1235 is different from any other legislative action in California or the country in that it attempts to lump non-lending transactions in with lending transactions and impose the same disclosure requirements. This is not done in consumer transactions in California or federally. For example, California does not impose consumer lending transaction disclosures on inheritance financing transactions (the purchase of inheritance payments), structured settlement financing (purchase of lawsuit settlements) or lottery financing (purchase of lottery payments). Nor does the federal government treat consumer leasing transactions the same as consumer loans (TILA applies to consumer loans and the Consumer Leasing Act applies to consumer leases). There are reliable and long standing policy and legal reasons why consumer loans are treated differently than consumer lease and purchase transactions. Those same reliable and long-standing policy and legal reasons apply to commercial loans and commercial lease and purchase transactions. Yet, SB 1235 treats all of these transactions the same, which will simply cause a massive amount of confusion that will disserve small businesses and make disclosures more confusing, less reliable and clearly frustrate the purpose of SB 1235.

F. Types of Financing Requiring Estimated Annualized Rates

Any transaction that does not have fixed payment amount, fixed payment dates and a fixed term will require an estimation of an annualized rate.

G. Fees and Charges Included in an Annualized Rate Calculation

We recommend including all fees charged by a Provider in the rate disclosure. One of the lessons learned from TILA and the APR is that creating unique rules for various fees creates numerous issues. First, it makes the APR calculation more challenging as an analysis is required for each and every fee to determine if the fee is a finance charge and included the APR calculation. Second, it creates an incentive for lenders to create questionable fee structures in an effort to artificially lower the APR. In fact, it is these exact issues that are the reason why the CFPB is planning to reassess the APR calculation and what fees should be included (see the discussion on TRID rules above).

We also believe the regulation should make it clear that any fees charged by third parties and paid directly to third parties by the customer should not be included the rate calculation.

H. Calculating Estimated Terms and Estimated Annualized Rates

The Invitation requests comments on how Providers should calculate estimated terms and estimated annualized rates for the various commercial financing transactions subject to SB 1235. It is difficult to suggest how rates should be estimated until a decision has been made on what type of rate is going to be used. There are numerous issues with estimated rates for APR given the precision and specificity of the TILA APR calculations. However, for the ACC or some other newly created rate disclosure, there is much more flexibility in how to handle calculations and estimates as it does not force products into a regulatory regime and mathematical formula that was never intended to handle these types of products. Accordingly, we suggest the DBO propose a rate and then ask for comments on how to address issues raised by the use of that specific rate.

If an estimated annualized rate is required to be disclosed, it will create the potential for litigation against Providers. Such estimated disclosures may be required through projections or examples and when it is later determined that the projections or examples provided were different than the actual cost of the financing, litigation against Providers will skyrocket. An active plaintiff's bar in California would use the good faith effort of the Provider to comply with SB 1235 and the implementing regulations to file hundreds and possible thousands of lawsuits. If so, there will be a dramatic impact on small business financing in California as many Providers will cease providing financing to small businesses in California. Therefore, we request that the DBO provide rules and regulations to make it clear that a cause of action is not available to recipients based on the disclosures made by examples or projections so long as such disclosures are provided in good faith by the providers.

I. Reliance Upon Internal Underwriting Criteria to Calculate Estimated Terms and Estimated Annualized Rates

Estimated terms should simply be the term the Provider used to underwrite and/or price the product. We also suggest that the regulation create some rule as to how this data should be verifiable to provide documentary proof to the customer of the estimated term. This will help reduce instances of Providers creating artificial terms for the sole purpose of deflating the disclosed rate.

J. Explanatory and Qualifying Language in Connection with Estimated Terms and Estimated Annualized Rates

This disclosure is bound to cause confusion as it highlights a fundamental flaw with SB 1235 - it attempts to treat loan and purchase transactions the same. As explained elsewhere in this letter, this has never been done for long standing policy and legal reasons. In the consumer context, treating leases like loans makes no sense and is why the federal government enacted both a lending disclosure law (TILA) and a leasing disclosure law (Consumer Leasing Act). This is also why California has a consumer loan law and an inheritance financing law (one applies to loans the other to purchases). Trying to force purchase transactions to make loan disclosures and then attempt to resolve the various issues created by doing so by adding more disclaimers and disclosures to explain the amounts and terms will cause information overload and make all disclosures meaningless. This is what happened with consumer mortgage disclosures over the last 30 years and why the CFPB recently made major changes to federal mortgage disclosure rules (the TRID rules).

K. Disclosures for Factoring and Asset-Based Lending Transactions with Master Financing Agreements

The relevant provisions of SB 1235 addressing these master financing agreements are confusing to us. We do not currently use master financing agreements so this is not directly relevant to us. However, it would seem that permitting disclosures based on sample terms will simply open the door for Providers to restructure products to have master financing agreements and provide sample disclosures that are not representative of most of the underlying transactions.

L. Tolerances

It is difficult to suggest how tolerances should addressed until a decision has been made on what type of rate will be used. There are numerous issues with the use of an APR given the precision and specificity of the TILA APR calculations. However, for the ACC or some other newly created rate disclosure, there is much more flexibility for handling calculations and tolerances may not be so complicated. Accordingly, we suggest the DBO propose a rate and then ask for comments on how to address tolerance issues for the specific rate.

M. Disclosure Formatting

We would first like to see all proposed disclosures and related explanations before proposing a specific format and structure. However, generally speaking we think the proper order would be the amount provided first, then the total payback amount (which is not a required disclosure but should absolutely be added for the disclosure regime to be comprehensive), the total dollar cost, the applicable rate, the payment amounts and structure and a statement regarding the prepayment policy. All of the required disclosures should appear on a page separate from all other disclosures and should be segregated from all other contractual terms. It is important that the recipient has quick and easy access to view the required disclosures. None of the required disclosures should be made more conspicuous than other required disclosures as the disclosures as a whole will be useful but any one disclosure by itself may be misleading and cause confusion. This is exactly why the CFPB recently moved the APR disclosure from the front page in mortgage transactions and also removed the requirement that it be more conspicuous than other disclosures.

N. Prepayment Policies

Prepayment policies vary by Provider and product. For some Providers there is no prepayment option, for others prepayment is permitted without penalty and for yet others prepayments are subject to an additional fee. All prepayment policies are currently disclosed in the customer agreements. Basic contract law requires that such penalties or fees be agreed to in the agreement and such contractual language must be sufficiently clear to avoid ambiguity or the Provider runs the risk of a court not enforcing the prepayment terms. Prepayment penalty language can be complicated and involve certain mathematical formulas so we do not believe a detailed description of the prepayment penalty amount should be included as part of the required disclosures. Rather, we think the regulations implementing SB 1235 should simply require that the required disclosures compel the Provider to include a statement as to whether or not a prepayment penalty is assessed and if so a reference to specific section in the underlying agreement where the amount or calculation is described.

Thank you for considering our comments. We remain committed to working with you to implement regulations that provide value to small businesses. We would be happy to discuss these matters in person or by telephone. You may reach me at 240-482-4684.

Very truly yours,

[redacted]

Joseph D. Looney
General Counsel

APPENDIX A

APR and ACC Comparisons

Below are a few examples showing the impact of payment frequency on APR and comparing APR to ACC. Note that we used the Office of the Comptroller of the Currency's ("OCC") APR calculator to calculate the APR for the single payment product and the monthly payment product. For the daily payment products, we used our own calculator as the OCC calculator does not provide the flexibility to properly calculate a TILA APR for a daily payment product (does not account for holiday or weekends which can materially impact the APR for daily pay products). Note that these comparisons involve only loan products and not purchased receivable products (such as MCAs) where payments vary from day to day and payments may not occur on a regular schedule.

This first example is for a one year loan with a single balloon payment at the end of the year. This example shows that ACC and APR are exactly the same when there is no declining balance during the term.

	ACC	APR	Advance Amount	Payback Amount	Fee Amount	Payment Amount
12 month balloon payment	30%	30%	$10,000.00	$13,000.00	$3,000.00	$13,000.00

The second example compares a product that has monthly payments with one that has daily payments. The pricing for the products is identical but the ACC and APR are different because of the impact of the payment frequency and the declining balance. This example shows that the impact of the declining balance has a compounding effect on APR making a product that is priced the same and has the same term look more expensive if payments are made more frequently.

	ACC	APR	Advance Amount	Payback Amount	Fee Amount	Payment Amount
12 month monthly pay loan	30%	51%	$10,000.00	$13,000.00	$3,000.00	$1,083.33
12 month daily pay loan	30%	57%	$10,000.00	$13,000.00	$3,000.00	$54.17

The third example is the same as the two examples above but increases the costs for the monthly pay product. The purpose is to show that a monthly payment product can charge more than a daily pay product but have the same or lower APR. In this example the dollar cost of the monthly product is actually 10% more expensive than the dollar cost of the daily pay product but has a 1% lower APR. This example shows that the APR will make customers think a product is cheaper but the product is in fact 10% more expensive.

	ACC	**APR**	**Advance Amount**	**Payback Amount**	**Fee Amount**	**Payment Amount**
12 month monthly pay loan	33%	56%	$10,000.00	$13,300.00	$3,300.00	$1,108.33
12 month daily pay loan	30%	57%	$10,000.00	$13,000.00	$3,000.00	$ 54.17

We believe these examples show the problems with APR calculations. It is for reasons like these that the Federal Reserve Board and CFPB have removed APRs in some consumer disclosures (like the historical APR in credit cards) and made APRs less important in other disclosures (like mortgages). Many people don't understand how significant an impact the declining balance has on the APR. In fact, most people think APR is just an annualization of the costs of a product and does not include the impact of the declining balance, which is precisely what the ACC does.

September 9, 2019

Submitted by Electronic mail to: regulations@dbo.ca.gov and [redacted]@dbo.ca.gov

Department of Business Oversight, Legal Division
Attn: Mark Dyer, Regulations Coordinator
1515 K Street, Suite 200
Sacramento, CA 95814-4052

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

Dear Commissioner Alvarez,

Small Business Financial Solutions, LLC dba RapidAdvance ("RapidAdvance") would like to thank the Department of Business Oversight ("DBO") for reaching out to stakeholders and inviting them to provide input on the above referenced rulemaking. RapidAdvance appreciates that the DBO invited industry participants ("Providers") to submit their thoughts and comments.

The draft regulations and sample disclosures ("Regulations") create a broad range of issues. In an effort to provide you with as much helpful information as possible to assist you in your rule making process, we are providing extensive comments. Given the length of this letter, we have segregated it into four parts. The first part is a description of our business. The second is a discussion of a few broad issues created by the Regulations. The third is a section-by-section review of the Regulations addressing the main issues created in each section. The fourth is a conclusion with some suggestions on how to address the various issues we raise. We had some concern with submitting such a detailed letter (one that addresses material issues but also small issues such as typos and grammatical errors) as we did not want the letter to be viewed as nitpicky. However, we concluded the more details we addressed, the more helpful our comments would be for you. So please accept even the comments about non-material items in the spirit they were intended.

We issued a comment letter in connection with the first request for comment. That comment letter provided a great deal of information regarding APRs and the problems with the use of APRs for the transactions subject to new Division 9.5 of the Financial Code (the "Code"). Unfortunately, the Regulations do not address many of the issues raised in our first comment letter. Instead of reiterating all of those issues in this letter, we request that our initial letter be reviewed again. We have repeated some of those concerns below but not all of them.

I. OUR COMPANY

RapidAdvance provides working capital to small businesses throughout the United States and operates as a licensed Finance Lender in California. RapidAdvance and its affiliates have been providing funding to small businesses for more than a decade and the majority of our customers have grown to become thriving businesses. Our financing products include merchant cash advances ("MCAs") and business loans. MCAs allow small retail businesses to sell their future card sales in exchange for immediate working capital (the transaction is a purchase and sale rather than a loan). The receivables we purchase are delivered to us whenever the merchant batches out its credit card terminal and forwards to us the percentage of funds that we purchased. The amounts RapidAdvance receives vary as we are only getting the percentage of receivables we purchased (*e.g.*, 20% of the credit card receivable).[1] Our small business loan is similar to a traditional commercial loan with two primary differences. First, the borrower makes daily or weekly payments rather than monthly payments. Second, our loans charge a fixed fee rather than an interest rate. A fixed fee allows our customers to easily determine the actual dollar amount the loan will cost and the more frequent payment schedule ensures the business is not overwhelmed by large monthly payments. Our underwriting model allows us to fund businesses that traditional lenders turn away and permits us to offer financing solutions to businesses whose growth is constrained by their ability to access capital. Our customers that qualify for both the loan product and the MCA can choose the product that best fits their needs.[2]

The customers that use our financing products include almost every type of small and medium sized business in America. Our customers' annual revenue generally ranges from $250,000 to $4,000,000. The average funding we provide is about $50,000. Approximately 90% of our customers are limited liability companies or corporations. The online small business finance industry now originates more than $15 billion annually and the overwhelming majority of small businesses that have obtained financing from industry participants prefer our products and process over traditional financing sources.

II. BROAD CONCERNS WITH THE REGULATION

A. Exceeding Authority

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[1] Note that this is the only MCA product offered by RapidAdvance (*e.g.* a purchase of a percent of a business' daily credit card receivables) and we refer to this as a traditional MCA where payment amounts are not fixed. Others in the industry offer another MCA product in which a percent of the business' daily gross revenue is purchased and where the payment is a fixed amount each day unless the merchant notifies the finance company of a change in their gross revenue. In both cases, the finance company is purchasing a revenue stream similar to traditional factoring transactions (traditional factors purchase payment obligations owed by customers to the business and MCA finance companies purchase payment obligations owed by card acquiring banks to the business).

[2] There is a broad misconception that MCAs are more expensive than loans. That is not true. MCAs and loans offer different value propositions to customers and some of our MCAs are less expensive than some of our loans.

The Code provides a set of definitions and disclosures for commercial financing transactions. In providing the Commissioner the authority to issue regulations, the Code states:

> The commissioner shall adopt regulations governing the disclosures described in paragraphs (1) to (5), inclusive, of subdivision (b) of Section 22802 and paragraphs (1) to (5), inclusive, of subdivision (a) of Section 22803. Those regulations shall include all of the following:
>
> (1) Definitions, contents, or methods of calculations for each of the disclosure items set forth in each applicable paragraph of subdivision (b) of Section 22802 and subdivision (a) of Section 22803.
>
> (2) Requirements concerning the time, manner, and format of the applicable disclosures described in subdivision (b) of Section 22802 and subdivision (a) of Section 22803.
>
> (b) The commissioner shall adopt regulations concerning the annualized rate disclosure described in paragraph (6) of subdivision (b) of Section 22802 and paragraph (6) of subdivision (a) of Section 22803. Those regulations shall include all of the following:
>
>> (1) A determination of the appropriate method to express the annualized rate disclosure and the types of fees and charges to be included in that calculation.
>>
>> (2) When providers shall be permitted to disclose an estimated annualized rate, and how such an estimate shall be calculated. The method of calculation determined by this paragraph shall specify the accuracy requirements and tolerance allowances for the calculation, and the types of fees and charges to be included in the calculation.
>>
>> (3) Requirements concerning the time, manner, and format of the disclosure.

This language gives the Commissioner specific and limited authority to draft regulations related to the twelve disclosure items described in 22802(b)(1)-(6) and 22803(a)(1)-(6). However, the draft Regulations appear to exceed this limited authority. For example, the Regulations modify terms defined in Section 22800 that do not appear in any of the twelve paragraphs cited, such as Asset-Based Lending Transaction. The Regulations also add or modify terms that are completely irrelevant to the disclosures required by 22802 and 22803, such as Depository Institution. Given that the Code exempts Depository Institutions from the disclosure requirements listed in 22802 and 22803, there would seem to be no statutory authority to support a modification of the term by the Regulations.

Further, the Regulations create a disclosure referred to as the "Estimated Monthly Cost." However, this disclosure is not one of the disclosures listed in the Code. In fact, this disclosure was not mentioned at any of the hearings for SB 1235, was never proposed by Senator Glazer and was never included in any of the model forms Senator Glazer prepared for the hearings and debates on SB 1235. In addition to this disclosure simply not being permitted under SB 1235, adding it would frustrate the purpose of SB 1235 as it detracts from other disclosures that the California Legislature deemed are more meaningful.

Additionally, despite the fact that SB 1235 is a disclosure bill, the Regulations create substantive requirements. For example, the Regulations require Providers of "Sales-Based Financing" that use an "internal estimated sales projection" to conduct an audit every twelve months. As part of the audit, the Provider must calculate a retrospective APR despite the fact that the APR created in TILA is not a retrospective calculation – it is always prospective. If the APR exceeds the limitations in the Regulations, the Provider may no longer calculate the estimated APR pursuant to Section 2092 of the Regulations. Nowhere does SB 1235 require Providers to perform audits. In addition to this being beyond the authority granted to the Commissioner by SB 1235, it creates a massive amount of confusion and risk (we address this below when we address this specific section).

B. Confusing

Generally, to satisfy the standards required by the Administrative Procedures Act ("APA"), a regulation must be legally valid, supported by an adequate record, and easy to understand. The APA was adopted as the Legislature found that the language of many regulations was unclear and confusing to persons who must comply with the regulations. "Clarity" means that the regulation was written or displayed so that the meaning of the regulations will be understood by those persons directly affected by them. Unfortunately, the Regulations do not satisfy this criteria. Despite the fact that RapidAdvance has been in the commercial finance industry for more than 10 years and that I have personally been advising companies on compliance with state and federal credit protection laws for more than 20 years, we are unable to understand what is required in some parts of the Regulations. Based on previous rulings by the Office of Administrative Law ("OAL"), the following is a list of some of the items that clearly fail to satisfy the clarity requirement:

1. Sales-based Financing: The addition of the concept of sales-based financing by the Regulations has muddled and confused the determination of which disclosure requirements of the Regulations are applicable to the various commercial transactions subject to the Code. This confusion renders the Regulations almost indecipherable.

   The Code defines four broad categories of commercial financing transactions: accounts receivable purchase transactions, asset-based lending transactions, commercial loans and lease financing. The Code defines factoring but as a type of accounts receivable transaction. Further, commercial open-end credit plan is also defined but it is a subset of commercial loans. The Code does not define or include the concept of sales-based financing.

The definitions of these four categories of commercial financing transactions give guidance to Providers to determine the disclosure requirements for the particular products they offer. However, the addition of sales-based financing by the Regulations severely detracts from the usefulness of the Code's definitions because it appears sales-based financing is meant to be a larger class of commercial financing that would include many transactions that also meet one of the four categories of transactions defined by the Code.

Unfortunately, only by dissecting various parts of the Regulations is it possible to ascertain the broad applicability of sales-based financing and the confusion it creates. Based on the definition of sales-based financing and the term's use throughout the Regulations, it appears that transactions that fit within one of the four categories of transactions defined by the Code would also be considered sales-based financing. For example, Section 2061 includes the disclosure requirements for closed-end transactions and includes the following phrase: "unless the closed-end transaction meets the definition of sales-based financing…." Based on this qualifier, certain closed-end transactions would appear to be sales-based financing.

Additionally, based on Section 2091, it would appear sales-based financing includes accounts receivable purchase transactions and asset-based lending. The title of Section 2091 is "Estimates –Accounts Receivable Purchase Transactions/Asset-based Lending Transactions – Historical Method." The title indicates that the text of the Section applies to accounts receivable purchase transactions and asset-based lending transactions. The text of the Section states, "[t]his section shall apply only to sales-based financing…." As such, Section 2091 demonstrates, by implication, that accounts receivable purchase transactions and asset-based lending are types of sales-based financing. Further, as the Code defines factoring as a type of accounts receivable purchase transaction, it would appear that certain factoring transactions are also sales-based financing.

Based on the foregoing, sales-based financing could include products in three of the four categories of transactions defined by the Code. This catchall nature of sales-based financing and the term's use throughout the Regulations blurs the distinctions between the original four categories. Without a clear divide between transaction types, it becomes impossible to discern which Sections of the Regulations apply to which transactions.

2. Spelling or Grammatical Errors: The Regulations have numerous spelling and grammatical errors throughout. By our count, there are more than a dozen such errors. The spelling and grammatical errors we found are noted in our section-by-section analysis in Part III along with proposed corrections.

3. Inconsistent Section Headings and Formatting: Some sections include the format and content requirements and others do not. For example, Section 2061 is entitled "Closed-End Transaction Formatting and Content Requirements," Section 2062 is entitled "Commercial Open-Ended Credit Plan Disclosure Formatting," and Section 2066 is entitled "Formatting and Content Requirements for Lease Financing." Furthermore, Section 2062 refers to "Open-Ended Credit Plans" but that phrase is not defined anywhere in the Regulations or SB 1235. SB 1235 refers to "Commercial open-end credit plan" and the Regulations do not define "Open-Ended Credit Plans."[3] It is unclear why different wording and placement is used and such variations increase the lack of clarity. Attached as Exhibit A is just a listing of the Section headings, which are copied identically, including punctuation, from the Regulations. Reviewing this makes it clear that many of the headings are inconsistent and contain grammatical errors.

   An additional issue that causes confusion is the outlining format differs from section to section. Section 2057 goes letters then numbers then numerals (*e.g.* (a)(3)(i)) but Section 2061 goes letters then numbers then letters again (*e.g.* (c)(1)(a)). Section 2062 actually uses both outlining formats in different locations.

4. Use of Incorrect Wording: Words are used in the wrong context throughout the Regulations. For example in the definition of the phrase "[a]t the time of extending a specific offer of commercial financing" only loans are referenced (it does not include non-loan products). However, SB 1235 and the Regulations apply more broadly to non-loan transactions. The definition should use the phrase "commercial financing" instead of loan.

   In Section 2065, there is a requirement that an Estimated APR be disclosed. However, some provisions of the Section refer to just APR and not Estimated APR. For example, Section 2065(c)(3) refers to APR (not Estimated APR) despite the fact the Provider will only be disclosing an Estimated APR pursuant to this Section. The same issue appears in Section 2065(c)(4). A similar problem appears in Section 2065(f)(1) where

[3] Note that non-closed end credit is referred to under the relevant federal laws and virtually all state laws that use that phrase or a similar phrase as "open-end credit." The phrase open-ended is not the typical phrase used when referring to these credit plans.

there is a reference to “Payment Amount/Frequency.” Clearly this reference must be to “Estimated Payment Amount/Frequency” (even the applicable sample disclosure form uses the correct wording implying it was an error to not include it in Section 2065(f)(1)).

5. Use of Undefined Terms: Use of phrases that have no set definition creates confusion. For example, Section 2060(d) refers to the APR being expressed to the nearest ten basis points. Basis points is not defined in the Regulations and can have varying meanings in the marketplace. The lack of a definition for basis point is why most disclosure statutes avoid use of the phrase. Instead, they refer to decimal places or decimal equivalents. Additionally, Section 2057(a)(5) refers to a “publicly available” rate index. What does publicly available mean? If an individual creates their own index and publishes it online for the public to view, is that publicly available?

6. Use of Imprecise Terms or Inconsistent Terms: The Regulations have failed to satisfy the clarity requirement when they use expansive words such as “may” and “possible” (in some cases use of the word “may” has caused a regulation to fail the clarity requirement). For example, Subdivision 2061(e)(3) provides that “[if] periodic payments during the term of the transaction vary and it is possible to calculate . . . .” The word possible is not typically used in regulations as it creates an undue burden. Almost anything is possible and such words should always be avoided in contracts, litigation or legislative drafting.

   Section 3001(g) is also confusing and unclear as it only refers to APRs and does not reference Estimated APRs. Therefore, it appears this provision would not apply to Estimated APRs, but we doubt that was the intent.

7. Duplicate Provisions: When a regulation has the exact same requirement issued in two different sections, it creates confusion as to the purpose of the different sections. Section 3000 of the Regulations creates this issue. Throughout the Regulations, there are various requirements for an APR or Estimated APR disclosure requirement. These requirements are listed for each type of product being offered (*e.g.* the Regulations have specific disclosure requirements listed separately for closed-end transactions, open-end transactions, leasing, etc.) Each one of these sections requires an APR or Estimated APR. However, Section 3000 has a stand-alone APR disclosure requirement. It is unclear what the purpose of this section is and what it is intended to accomplish. In addition to the confusion this creates, it creates an unresolvable conflict with other sections. If Section 3000 solely requires an APR, does that mean the Estimated APR required in other sections is insufficient? Must a Provider that is disclosing an

Estimated APR under Section 2065 also disclose an APR under Section 3000? It is unlikely this was the intent but that is what the draft Regulations would require.

8. Unclear What Entities Must Comply: The Regulations fail to account for transactions where multiple Providers are involved in the negotiation and funding of a commercial financing transaction. Many Recipients work with third-party brokers when shopping for commercial financing. Provider, as that term is defined by the Regulations, would include these third-party brokers as well as the Finance Companies that provide the commercial financing to the Recipient. As such, the Regulations as currently drafted would require that both the broker and the Finance Company provide the Recipient a disclosure and obtain the Recipient's signature indicating it had received the disclosure. This duplicative disclosure requirement is likely to confuse a Recipient as to which entity is providing the commercial financing and the total number of offers being presented. We recommend that the Regulations clarify that a Recipient need only receive one disclosure statement from the Finance Company that is offering the commercial financing.

   Additionally, we recommend that the Regulations clarify that the term Recipient is limited to the entity or person (in case of sole proprietors) that is the primary obligor on the commercial financing. Providers should not be required to provide a disclosure statement to co-obligors or guarantors on the transaction nor required to obtain those parties' signatures indicating their receipt.

C. *Adopting Regulation Z Provisions*

The Regulations adopt many provisions from Regulation Z in an incomplete manner or without addressing the unique issues created by doing so. For example:

1. Subdivision 3001(d) adopts language from Comment (b)(1) of Appendix J, 12 C.F.R. Part 1026 relating to unit periods. However, that provision of Regulation Z has numerous additional provisions clarifying the unit periods and those issues are not addressed in the Regulations. These issues must be addressed in the Regulations to avoid confusion.

2. Subdivision 3001(e) is also copied verbatim from Appendix J, 12 C.F.R. Part 1026 (Comment (b)(2)). However, such incorporation of Regulation Z language simply highlights the issue of doing so. This provision applies only to closed-end credit but the Regulations make it apply to open-end credit (despite the fact the term concept is completely different in open-end credit) and other types of financing products which are not even addressed in Regulation Z. Additionally, the Regulation Z language assumes it applies only to lending transactions or credit sales (as defined under

Regulation Z). Many of the products subject to the Regulations do not have terms and are in fact not even lending transactions or credit sales. Therefore, adoption of the Regulation Z language to use for APR calculations is at best confusing. Different provisions of the Regulations refer to estimating terms for products with no fixed terms but Subdivision 3001(e) then requires all terms to be fixed by referring to "the date the last payment is due" and "on the ending date." This is simply an unworkable conflict between different provisions in the Regulations.

3. Subdivision 3001(f) provides the APR shall include all finance charges as defined in Section 3010. Section 3010 defines finance charge as all charges included in the finance charge under 12 C.F.R. § 1026.4 (assuming the transaction is a consumer credit transaction). Once again, adopting Regulation Z language is simply not adequate. For example, 12 C.F.R. § 1026.4(a) provides that a finance charge is a fee "imposed by a creditor" as "a condition of the extension of credit." Many of the Finance Companies subject to the Regulation are not creditors under Regulation Z and many of the products subject to the Regulation are not "extensions of credit" (the products do not include a right to defer payment for a debt). For example, an entity providing lease financing is not a creditor under Regulation Z and a lease transaction is not a credit transaction under Regulation Z. Therefore, any fees imposed by these Finance Companies or as part of such transactions are not finance charges as defined in the Regulations. Clearly, this is not what is intended but it highlights why borrowing specific language from Regulation Z and attempting to make that language apply to transactions not subject to Regulation Z is an enormous task that is riddled with potential errors, loopholes and problems.

In addition to the fact that adopting Regulation Z language for the transactions subject to the Regulations creates confusion and leads to logically inconsistent language in the Regulations, adopting APR from Regulation Z creates a litany of issues. As previously explained, APR is itself confusing and when you require APR disclosures for non-credit transactions, it creates a disclosure regime that is simply unworkable. This will lead to confusing and inconsistent disclosures and simply defeat the purpose of SB 1235 (which is to provide businesses with a disclosure regime that will enable them to compare financing costs). Some of the more prominent issues with the Regulations' adoption of APR are:

1. APRs in consumer transactions have proven to be confusing and not used by consumers to compare the cost of credit. The Federal Register is replete with quotes from federal agencies concluding that APR is confusing. For example, a review of the Integrated Mortgage Disclosure rule making process makes it abundantly clear that APRs are confusing and not used by consumers when shopping for credit. (*See* 78 Fed. Reg. 79730 (Dec. 31, 2013))(". . . consumers do not understand the APR and do not use it

when shopping for a loan."). The fact that APRs are confusing is also made clear by the fact that the requirement to disclose Effective APRs for credit cards was removed in 2007 (now only a corresponding APR is required to be disclosed and the corresponding APR is more similar to the Annualized Cost of Credit ("ACC") than the APR described in the Regulations)(*See* 72 Fed. Reg. 32955 (June 14, 2007)). Given that the express purpose of creating the APR was to assist consumers in comparing the costs of credit, the fact that the federal regulators have concluded the APR is confusing and not used by consumers when shopping for credit is a material finding. In fact, even Congress recognizes the APR is insufficient and does not serve its intended purpose. The Dodd-Frank Act amended TILA to require a new rate disclosure - the Total Interest Percentage ("TIP"), which is simply the total amount of interest that the consumer will pay over the life of the loan expressed as a percentage (*e.g.,* a $100,000 mortgage loan with $50,000 of interest over the life of the loan would have a TIP of 50%). *See* Dodd-Frank Wall Street Reform and Consumer Protection Act § 1419(19). The TIP disclosure is an attempt to provide information to consumers that is more useful than APR, easier to understand and easier for creditors to calculate. The TIP calculation is basically the ACC but not annualized.

Additionally, the APR was not intended to provide an apples to apples comparison across all types of lending products. In fact, TILA calculates the APR differently for open-end and closed-end credit and even certain closed-end credit transactions calculate APRs differently. These differences are due in large part to what types of fees are included in the calculation (*e.g.* mortgage loan APR calculation might exclude a fee that an automobile loan includes).

2. Subdivision 3001(a) requires the APR to be calculated in accordance with Appendix J, 12 C.F.R. Part 1026. However, this section is the APR calculation for closed-end credit only. So the Regulations require a closed-end calculation even for open-end programs.

3. Section 3001 borrows the 1/8 of one percentage point tolerance from TILA and Subdivision 2060(d) requires APRs be "expressed to the nearest ten basis points." These two provisions together create material risk for Providers. The tolerance levels under TILA make sense under TILA but only because TILA provides specific guidance on calculations and makes it possible for creditors to disclose very accurate APRs under TILA. Additionally, TILA does not require the APR to be disclosed to a specific decimal place. TILA does this intentionally as it permits APRs to only be whole numbers but provides flexibility to disclose decimals if required to satisfy the tolerance limits. In this regard, in connection with open-end credit APRs, Regulation Z states the following:

> The regulation does not require that the annual percentage rate be calculated to any particular number of decimal places; rounding is permissible within the 1/8th of 1 percent tolerance. For example, an exact annual percentage rate of 14.33333% may be stated as 14.33% or as 14.3%, or even as 14 1/4%; but it could not be stated as 14.2% or 14%, since each varies by more than the permitted tolerance.

12 C.F.R. § 1026.14(a), Comment 2. For purposes of the Regulations, requiring a tolerance limit of 1/8 of one percentage point is simply too narrow and will create material risk for Providers. The Regulations fail to address many calculation issues created by using APRs for the unique products that are subject the Regulations. Even Regulation Z recognizes that for unique and complicated transactions, a higher tolerance is permitted. *See* 12 C.F.R. § 1026.22(a)(3)(permitting a 1/4 point tolerance). Additionally, the Regulations limit the APR from being overstated by the same tolerance. This language appears to have been adopted from Regulation Z. However, case law under TILA provides there are no penalties for overstating an APR. Other provisions of California law will create material risk for Providers as they could be sued for overstating APRs when that should not be permitted (there is no actual harm when an APR is overstated). Accordingly, we suggest the tolerance apply just to understatements and the Regulations provide that all overstatements are deemed accurate.

Furthermore, there is no reason to mandate that APRs be "expressed to the nearest ten basis points." This is not required under TILA and simply adds a level of complication that is unnecessary (assuming the tolerance level issues are addressed).

4. Disclosing an APR (even if all calculation issues were resolved) will be confusing for non-credit, non-consumer transactions. Requiring an APR disclosure that is universally known as a lending or credit sale disclosure will be misleading for the types of products covered by the Regulations. APR will be even more confusing in the business financing industry as payment terms are so unique. APR can be misleading for many of the more innovative products that provide more frequent payments or unique repayment features. For example, two products with identical pricing and terms will have different APRs if one is a monthly payment product and one is a daily payment product. In fact, a monthly product can be materially more expensive on a dollar basis than a daily pay product but still have a lower APR. This can lead a small business to believe a product is cheaper when in fact the product is more expensive.

5. In addition to the fact that the language used in the Regulations in connection with APRs is confusing, incomplete and sometimes contradictory, the Regulations fail to address necessary topics. For example, any rate disclosure should be made based on

> the assumption that all payments are made when due and rate changes caused as a result of delinquency or default should be excluded from the disclosure. This is precisely the guidance provided by Regulation Z (*See* 12 C.F.R. §1026.18(f) Comment 1).

Requiring rate disclosures typically used for loans (such as APR) to be used for non-loan products (MCAs, factoring, leasing, etc.) will create massive confusion. APR has never been imposed on consumer purchase and sale transactions (in fact such transactions are expressly excluded from TILA). It is impossible to calculate even an implied rate for purchase and sale transactions because there is no fixed term or accruing rate. Because purchase transactions do not require specific amounts to be paid at a designated frequency, the term for these products cannot be calculated until after the transaction has concluded. Without a known term, only an estimated term and rate can be provided, which means the annualized rate and term disclosed will be, by definition, incorrect and misleading. For this reason, no state or federal law has ever required APR to be disclosed for these products – consumer or commercial. For example, TILA does not apply to purchase and sale transactions with consumers. Rather, it applies only to loans, lines of credit and retail installment financing transactions. Accordingly, TILA does not apply to transactions with consumers when they sell something for a lump sum, such as lottery winnings, inheritance proceeds, litigation proceeds, etc. APR disclosures are not required in any of these transactions because implying a rate disclosure on a purchase transaction is confusing and unwarranted. For these types of consumer transactions, many states have taken action and provided their own disclosure regimes that do not artificially treat purchase transactions as loans but recognize them for what they are under the law and require appropriate disclosures. *See e.g.*, Cal. Prob. Code §. 11604.5 (law regulating the sale of inheritance proceeds where APR is not required but other disclosures are required). Even the federal Equal Credit Opportunity Act respects the distinction between financing transactions and purchase and sale transactions. *See* 12 C.F.R. § 1002.9(a)(3) – Comment 3 ("Factoring refers to purchase of accounts receivable, and thus is not subject to [ECOA or regulation B]"). Despite all of this, the Regulations treat loans, lines of credit, purchase and sale transactions, factoring, and leasing all the same.

When confronted with similar issues at the federal level, regulators have taken a much different approach. For example, federal regulators recognize that a leasing transaction and loan transaction are not the same and should not have the same disclosures. So an APR is required under TILA for consumer credit transactions but for consumer lease transactions different disclosures are required under the Consumer Leasing Act.

Finally, given the Regulations adopt APR, finance charge and other terms from Regulation Z but then change the definitions and calculations dramatically, there is a question of whether the Regulations would be preempted. 12 C.F.R. § 1026.28(a)(1) provides that:

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

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

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

The Regulations do precisely this. It incorporates Regulation Z's definition of finance charge and then amends it (in direct contradiction to (i) above). The Regulations also mandate use of APR but then change how APR is calculated and also create new disclosures and APR calculations called Estimated APR (if a phrase such as nominal APR is preempted by Regulation Z, clearly the phrase Estimated APR is preempted). APR and finance charge are terms of art created by TILA and Congress wanted the terms to be protected so that the disclosures would not lose meaning by states redefining them and then using the same term in other transactions. Comment 2 quoted supports this conclusion as it makes it clear that the terms finance charge and APR and their definitions or calculations are to be protected and not altered in any inconsistent manner by state law. These preemption rules are not limited to consumer transaction only. In fact, the statutory provisions in TILA addressing preemption are not expressly limited to consumer credit transactions. *See* 12 U.S.C. § 1610(a)(1). When Regulation Z intends for the preemption rules to be limited only to state laws applying to consumer credit transactions, it expressly states so. For example, Comment 2 to 12 C.F.R. § 1026.28(d) provides that preemption for credit card and charge card rules applies only to consumer transactions and not to business transactions. There is no such limiting language for preemption under 12 C.F.R. § 1026.28(a)(1).

Given the above, we believe the DBO should adopt a new rate disclosure and not use APR. If a rate is required for commercial financing products, the required rate must be easier to calculate than APR and be less confusing than APR. A rate more easily understood and calculated is preferable to APR as it will make comparison shopping easier and will be more likely to be used for its intended purpose – to compare costs. The Regulations have the potential to be a standard for the nation for commercial financing transactions. However, by using APR and all of its issues, it is unlikely the Regulations become a national standard.

III. SECTION-BY-SECTION ANALYSIS

§ 2057. – Definitions.

1. At the time of extending a specific offer of commercial financing

   Subdivision 2057(4)(i) limits the definition of "at the time of extending a specific offer of commercial financing" to "[t]he time when the terms of a final loan offer are made to a recipient…." Clearly, this definition should not be limited only to loans. Rather, it should apply to all commercial financing subject to the Regulations.

2. Bona-fide true-up amount

   a. It is unclear if, to meet the definition of bona fide true-up amount, the requirements of both (i) *and* (ii) must be met or if only the requirements of (i) *or* (ii) must be met. The definition begins, "'Bona fide true-up amount' means both:…." The text then details requirements in Subdivisions (i) and (ii). In contrast, Subdivision (ii) itself has two sub-requirements and it is clear from the text that both must be met as indicated by its text: "A true-up amount to be owed by the recipient where both of the following are true:…." Given the language used by Subdivision (ii) to indicate that both its sub-requirements must be met, the language "'Bona fide true-up amount' means both:…" would seem to indicate that only (i) or (ii) must be met. However, this would mean that a bona fide true-up amount could exist where only the Finance Company is required to pay a "true-up amount" to the Recipient, pursuant to Subdivision (i), or where only the Recipient is required to pay a "true-up" amount to the Finance Company, pursuant to Subdivision (ii). This result does not reflect industry practice where "true-up" payments may be required to be paid by either party. We recommend this definition be clarified by revising the first clause as follows: "Bona-fide true-up amount means a true-up amount where both of the following are true:…."

   b. This definition references the term "true-up amount" but the term is not defined in the Regulations and does not appear in the Code. Given that the term is used throughout the Regulations, we would recommend it be defined.

3. Finance Company

"Finance company means the individual or institution providing the commercial financing to the recipient." The term "institution" is not defined in the Regulations or the Code. The term "person," however, is defined in the Code and includes "an individual, a corporation, a partnership, a limited liability company, a joint venture, an associate, a joint stock company, a trust, or an unincorporated organization." Given that person is specifically defined as the entities listed, the use of the term institution indicates that either (i) the term Finance Company encompasses other entities not included in the definition of person, or (ii) that it does not include certain entities included in the definition of person. This uncertainty could be resolved by defining "institution" or revising the definition of Finance Company.

4. Payment Channel or Mechanism

The phrase "payment channel or mechanism" is used throughout the Regulations but is not defined by the Regulations or Code. Given that these are not standard commercial financing terms, we would recommend that they be defined.

5. True-up Period

This term is defined but is not used in the Regulations.

§ 2060[4] *– General*[5] *Formatting and Content Requirements.*

1. Use Of The Term "You"

The use of the term "you" in the disclosures required by Subsection (a) and (b) creates ambiguity as to the entity to which the disclosure is directed and from which the Provider must obtain a signature. While use of the term "you" is common in consumer finance contracts to assist the individual obligor understand the provisions of an agreement, it is an unsuitable term to use in commercial contracts. As "you" is a pronoun used to refer to an individual, it would be grammatically incorrect to use the word to refer to a business entity such as a corporation or limited liability company. Moreover, the disclosure required by Subsection 2060(a) includes a phrase stating that the disclosure is provided "to help you understand your business financing" which, by its own terms is directed to a natural person capable of understanding written text and, therefore, is grammatically incorrect if directed to a business entity. A business entity

[4] No period is present following this Section number or for Section numbers 2061 and 2067. A period follows the Section number for all other Sections.
[5] Please see our comments regarding use of the term 'General' in paragraph 1 of our comments to Section 2064 *infra*.

is a legal construct that lacks the ability to comprehend or understand anything and therefore relies on its human agents for such analysis. Therefore, requiring a business entity to attest to understanding a disclosure is simply nonsensical.

The ambiguity created by Subsections 2060(a) and (b) is heightened by the fact that the signature block required by Subsection (b) fails to provide for a space where the legal name of the entity applying for commercial financing could be identified. Rather, the subsection requires the generic label "Applicant Signature" be used to indicate where an applicant is to sign. This generic label and the use of the personal pronoun "you" provides little clarity as to the entity that is signing the disclosure (e.g. business entity, guarantor or both). A Provider is unable to clarify these ambiguities as Subsection (f) states the disclosures required by the Section 2060 are to be provided separately "from any other contract or disclosure document provided to the recipient."

2. Applicant vs. Recipient

The use of the term "applicant" in Subsection (b) of Section 2060 implies that the disclosure may be provided to parties other than the "recipient," as that term is defined in Subsection 22800(n). However, neither the Code nor Regulations provide for such ancillary disclosures. We would recommend "applicant" be replaced with "recipient" in Subsection 2060(b) for consistency and clarity.

3. Partial Months

Subsection (c) of Section 2060 requires that the term or estimated term of a transaction be expressed in units of years and months with partial months being expressed to the nearest two decimal points. It is unclear how expressing a partial month as a decimal number would be useful information to an applicant and seems likely to cause confusion given the other numerical disclosures required to be given. As an example, a transaction with a term of 307 days would be disclosed as "0 years, 10.27 months." As partial months are colloquially referred to in days or weeks rather than decimals, comprehension would likely be increased by ending the disclosure at whole months or disclosing partial months as days.

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

1. Closed-End Transactions Cannot Be Sales Based Financing

The first sentence of Section 2061 provides that disclosures for closed-end transactions must comply with the requirements of the section, "unless the closed-end transaction meets the definition of sales-based financing…." However, the definition of a closed-end transaction excludes sales-based financing. The Regulations define a closed-end transaction as a single extension of credit that is "repaid in regular predetermined payments of a specified amount over a fixed period of time" (emphasis added). In contrast, sales-based financing is a transaction that is paid "as 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" (emphasis added). The definitions are mutually exclusive. As such, the phrase "unless the closed-end transaction meets the definition of sales-based financing…" is unnecessary and confusing. We recommend the phrase be deleted.

2. Closed-end Transactions Cannot Have Adjustable Rates

Disclosures required by this Section apply to transactions with adjustable rates but the definition of closed-end transactions would exclude finance contracts subject to adjustable rates. As stated above, a closed-end transaction is one in which credit is repaid in predetermined, specified payment amounts. By definition, this excludes transactions in which payment amounts change according to adjustable interest rates.[6] As such, the subsections that describe disclosures for adjustable rate products should be deleted as these products are not closed-end transactions as defined in the Regulations.

3. Deductions

Subdivision 2061(b)(2) requires the Amount of Funds Provided to exclude "deductions." However, the term deductions is undefined. As the term "deductions" is not defined, it is unclear what items must be excluded from the Amount of Funds Provided. The sample disclosure only references fees as a possible deduction. The Regulations do not specify if other costs that may be deducted at origination would be considered deductions, such as, UCC filing fees, credit report fees, third-party payments or payoffs that may have been disbursed by the Provider on the behalf of the Recipient. We recommend that the term "deductions" be defined.

4. Average Monthly Cost

[6] The inherent conflict between adjustable rate products and the definition of closed-end transactions is most apparent in Subdivision (e)(4) which provides for disclosure requirements for products where the "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…." This Subdivision is clearly misplaced as Section 2061 is meant to only include closed-end transactions where the periodic payments are specific predetermined amounts.

Subsection 2061(j) requires average monthly cost disclosures for non-monthly pay products. It is unclear how disclosing an inapplicable and hypothetical payment amount would be useful information to an applicant. More importantly, the disclosure seems likely to cause confusion given that the information would conflict with the written terms of the commercial financing agreement. Additionally, the Regulations fail to explain how a Provider is to calculate the average monthly cost. We would recommend this subsection be deleted.

5. Use Of The Term "You"

Multiple subsections of Section 2061 use the terminology "you" and "your;" as explained in paragraph 1 of our comments to Section 2060, *supra,* this terminology is inappropriate for disclosures to business entities. We recommend these references be revised accordingly.

6. Spelling/Grammatical Errors

a. 2061(e)(1) – lacks ":."

b. 2061(e)(2) – sublevel headings are inconsistent with (e)(1).

c. 2061(h)(3) – missing opening quotation mark to "The total finance charge…."

d. 2061(c) – the third sentence of the last paragraph is incorrect, it reads "Although your interest rate will adjust over time based upon the [name of benchmark rate], for the purposes of this APR estimate, we have assumed that APR will be fixed for the length of the transaction." Rather, the last clause should read "…we have assumed that your interest rate will be fixed for the length of the transaction." APR is the result of the mathematical equation to which this sentence relates, as such it is not a variable for which an assumption would be made.

§ 2062. – Commercial Open-Ended[7] Credit Plan Disclosure Formatting.

1. Use Of The Term "You"

Multiple subsections of Section 2062 use the terminology "you" and "your;" as explained in paragraph 1 of our comments to Section 2060, *supra,* this terminology is

[7] Subsection 22800(f) defines the term "Commercial Open-End Credit Plan;" however, Section 2062 and other Sections throughout the Regulations reference "Open-Ended." We recommend that the Regulations conform to the statutory text.

inappropriate for disclosures to business entities. We recommend these references be revised accordingly.

2. Deductions

Subdivision 2062(c)(2) requires the Amount of Funds Provided to exclude "deductions." Please see our related comments explained in paragraph 3 of our comments to Section 2061. Additionally, the text used in this Subdivision to describe the deductions to be made differs from the text used by Sections outlining the disclosure requirements under 2061-2065 and 2067. These Sections state that "any deductions" must be excluded. In contrast, Subdivision 2062(c)(2) states that only "deductions required under the contract" must be excluded. It is unclear why the deductions required to be made for open-end credit plan disclosures should differ than those of other commercial financing transactions. We recommend that the language be revised to align with the text of Sections 2061-2065 and 2067.

3. Average Monthly Cost

Subsection 2062(k) requires average monthly cost disclosures for non-monthly pay products. Please see our related comments in paragraph 4 of our comments to Section 2061.

4. Spelling/Grammatical Errors

    a. 2062(f)(2) - subdivision headings are inconsistent with other subsections.

    b. 2062(f)(2)(iv) – in the third sentence, 'describe' should be 'describing.'

    c. 2062(i)(3) – the quoted language is missing the opening quotation mark.

    d. 2062(j)(2) – the reference to subdivision (i)(1) should be (j)(1).

§ 2063. Factoring Disclosure Format[8]

1. Factoring Transactions Where Multiple Accounts Are Sold

Factoring transactions generally involve a Recipient selling multiple accounts to a Provider at one time. However, the Regulations do not address factoring transactions

[8] No period is present following this Section title or for Section titles 2064, 2065, 2071, 2090 and 3003. A period follows the Section titles for all other Sections.

where multiple accounts are sold at the same time. References throughout Section 2063 make it clear that multiple account sales were not accounted for in the factoring transaction disclosure requirements. Subdivision (c)(3) details the disclosure of an estimated annual percentage rate and requires language which only references a single account - "This estimate assumes that you will assign the [description of asset assigned, e.g. 'invoice'] to [name of financing company] today, and your customer will pay the [name of asset assigned, e.g. 'invoice'] in full on the due date." Subdivision (f)(2) requires the disclosure of an estimated term calculated pursuant to Section 2090 which provides "…a provider shall calculate the estimate[d] term by calculating the time between when the provider will advance the original advance amount, and when the legally enforceable claim will become due and payable." Neither of these Subdivisions envision the sale of multiple accounts with differing payment terms. We recommend the Regulations provide guidance on this issue given how commonly it occurs in factoring transactions.

2. <u>Use Of The Term "You"</u>

Multiple subsections of Section 2063 use the terminology "you" and "your;" as explained in paragraph 1 of our comments to Section 2060, *supra,* this terminology is inappropriate for disclosures to business entities. We recommend these references be revised accordingly.

3. <u>Deductions</u>

Subdivision 2063(b)(2) requires the Amount of Funds Provided to exclude "deductions." Please see our related comments in paragraph 3 of our comments to Section 2061.

4. <u>Spelling/Grammatical Errors</u>

   a. 2063(b)(3) – unnecessary ")" at end of sentence.

   b. 2063(e)(3) – unnecessary ")" at end of sentence.

   c. 2063(f)(a) – should be (f)(3) rather than (f)(a).

§ 2064. General Factoring Disclosure Format

1. <u>Use Of The Term, "General"</u>

The use of the term "general" in the title of Section 2064 is confusing as it is not used in its standard definitional meaning of "considering or including the main features of elements of something." Rather it appears to be a reference to the use of the term in Section 22803 where the Code states:

> "a provider who offers commercial financing that is factoring or asset-based lending and that offers the recipient an agreement that describes the <u>general</u> terms and condition of the commercial financing transaction that will occur under the agreement, may provide the following disclosures as an example of a transaction that could occur under the <u>general</u> agreement…"

(emphasis added). Additionally, the use of the term "general" in Section 2064 conflicts with its use in Section 2060 where it is used in its standard definitional meaning. As the requirements of Section 2064 are, in fact, not the general disclosure requirements for factoring transactions pursuant to the Regulations, we would recommend the title of the Section be revised. A suggestion would be "Factoring Disclosure Format for Example Transactions."

2. <u>Use Of The Term "You"</u>

   Multiple subsections of Section 2064 use the terminology "you" and "your;" as explained in paragraph 1 of our comments to Section 2060, *supra,* this terminology is inappropriate for disclosures to business entities. We recommend these references be revised accordingly.

3. <u>Deductions</u>

   Subdivision 2064(c)(2) requires the Amount of Funds Provided to exclude "deductions." Please see our related comments in paragraph 3 of our comments to Section 2061.

4. <u>Spelling/Grammatical Errors</u>

   a. 2064(b)(b.)(i) – "enforcement" should be "enforceable."

   b. 2064(b) – subdivision headings are inconsistent with other subsections.

§ 2065. Sales-Based Financing Disclosure Formatting

1. <u>Use Of The Term "You"</u>

Multiple subsections of Section 2065 use the terminology "you" and "your;" as explained in paragraph 1 of our comments to Section 2060, *supra,* this terminology is inappropriate for disclosures to business entities. We recommend these references be revised accordingly.

2. Estimated Finance Charge

Subdivision (d)(1) only provides for the provision of an estimated finance charge. However, many commercial financing transactions that would be subject to the disclosure requirements of Section 2065 have fixed finance charges. Therefore, subdivision (d)(1) should permit the use of finance charge or estimated finance charge.

3. Average Monthly Cost

Subsection 2065(e) requires estimated monthly cost disclosures regardless of the payment frequency of the specific transaction. Please see our related comments in paragraph 3 of our comments to Section 2061.

4. Payment Amount/Frequency

Subdivision (f)(1) requires a disclosure of "Payment Amount/Frequency;" however, Subdivision (f)(2) provides for the calculation and disclosure of an "estimated periodic payment." As the payment amounts disclosed pursuant to this subsection will be estimated, the title of the disclosure of subdivision should read "Estimated Payment Amount/Estimated Frequency."

5. True-up Amounts

While a true-up mechanism is found in some types of commercial finance products, it is not a characteristic of most sales-based financing transactions. For example, RapidAdvance's MCA transactions do not include a true-up mechanism because RapidAdvance receives the portion of credit card receivables it purchased from the merchant from the merchant's credit card processor. As such, a true-up mechanism is unnecessary because RapidAdvance receives the exact amount of receivables to which it is entitled each day. Many Providers offer MCAs with the same direct split functionality as RapidAdvance. However, Subdivision (f)(3) would require these Providers to disclose "a description of anticipated monthly bona fide true-up amounts" even though this concept is inapplicable to their MCA products. Given the inapplicability of a true-up mechanism for many sales-based financing transactions, this subdivision should only be required for transactions for which it would be applicable.

Additionally, it is unclear what information is required to be disclosed pursuant to the text of Subdivision (f)(3) that states a Provider must provide "a description of anticipated monthly bona fide true-up amounts…." In contrast to the immediately foregoing clause, this text does not require a Provider to describe "how" it calculated the anticipated monthly bona fide true-up amounts, rather it requires the Provider to give a description of these amounts. It is unclear how a Provider would disclose a "description" of a payment amount or the value of such disclosure. As such, we recommend Subdivision (f)(3) read as follows: "In the third column, a description of how the provider calculated daily payments."

6. Spelling/Grammatical Errors

In section 2065(e)(2), the word "based" should be deleted.

§ 2066. Formatting and Content Requirements for Lease Financing.

1. Use Of The Term "You"

Multiple subsections of Section 2066 use the terminology "you" and "your;" as explained in paragraph 1 of our comments to Section 2060, *supra,* this terminology is inappropriate for disclosures to business entities. We recommend these references be revised accordingly.

2. Average Monthly Costs

Subsection 2066(j) requires average monthly cost disclosures for non-monthly pay products. Please see our related comments in paragraph 4 of our comments to Section 2061.

§ 2067 General Asset-Based Lending Transaction Disclosure Formatting.

1. Asset-Based Lending Transactions and Section 22802

The Regulations fail to provide disclosure requirements for asset-based lending transactions pursuant to Section 22802. Section 22803 permits Providers of factoring and asset-based lending transactions, as an alternative to the requirements of Section 22802, to provide disclosures pursuant to an example transaction that could occur under the Provider's general agreement. However, these Providers are not required to use the alternative disclosure requirements of Section 22803 and may provide a disclosure pursuant to Section 22802. The Regulations provide for disclosure requirements for factoring transactions pursuant to Section 22802 in Section 2063; however, the Regulations fail to provide disclosure requirements for asset-based lending transactions pursuant to Section 22802. An additional section should be added to provide for these disclosure requirements.

2. <u>Use Of The Term "You"</u>

Multiple subsections of Section 2067 use the terminology "you" and "your;" as explained in paragraph 1 of our comments to Section 2060, *supra,* this terminology is inappropriate for disclosures to business entities. We recommend these references be revised accordingly.

3. <u>Deductions</u>

Subdivision 2067(c)(2) requires the Amount of Funds Provided to exclude "deductions." Please see our related comments in paragraph 3 of our comments to Section 2061.

4. <u>Use Of The Term, "General"</u>

The use of the term "general" in the title to Section 2067 is confusing. Please see our related comments in paragraph 1 of our comments to Section 2064.

§ 2070. Signatures.

Businesses that seek commercial financing are often in need of the funds quickly, either to take advantage of a short-term opportunity or to address some other immediate need. The requirement that the signature of a Recipient be obtained on the disclosures will increase the amount of time it takes for Recipients to obtain commercial financing as Providers must first provide the disclosure statement to the Recipient and then wait to receive the signed statement before the transaction may be consummated. The use of electronic signatures will lessen the amount of time this process will take. However, Subdivision 2070(b) only authorizes a Provider to obtain a Recipient's signature electronically if the transaction is consummated via the internet. Yet many commercial financing transactions are conducted via fax and telephone. As such, the Regulations should allow a Provider to obtain the electronic signature of a Recipient on the required disclosures regardless of the manner in which the transaction is consummated. This should include all digital forms of signatures as well as voice authorizations.

§ 2071. Thresholds for Disclosure

Section 2071 does not explain how the amount of a commercial financing is to be determined for closed-end loans, accounts receivable purchase transactions and lease financing. We recommend guidance be added for each of these transactions.

§ 2089. Closed-end/Open-end Credit Plans with Payment Options.

This section is significantly confusing. In fact, we cannot figure out what type of transactions would be covered by these provisions and what the goal of this section is meant to be.

§ 2090. Estimated Term and APR – Factoring Transactions

1. <u>Estimated Term Factoring Transactions Where Multiple Accounts Are Sold</u>

   As discussed in paragraph 1 of our comments to Section 2063, the Regulations do not address factoring transactions where multiple accounts are sold at the same time. Subdivision 2090(a) explains how the estimated term is to be calculated by a Provider for purposes of disclosures under Section 22802. However, the calculation only envisions the sale of a single account, "…a provider shall calculate the estimate[d] term by calculating the time between when the provider will advance the original advance amount, and when the legally enforceable claim will become due and payable." The Subdivision does not address how to calculate an estimated term where the factoring transaction involves multiple accounts with differing due dates. We recommend the Regulations provide guidance on this issue given how commonly it occurs in factoring transactions.

2. <u>Spelling/Grammatical Errors</u>

   In section 2090(a), "estimate" should be "estimated."

§ 2091. Estimates –Accounts Receivable Purchase Transactions/Asset-Based Lending Transaction – Historical Method.

1. <u>Estimated Sales or Receipts Projections</u>

In many commercial financing transactions, a Provider will not have access to the information necessary to calculate the estimated monthly sales or receipts projection. Unlike a Finance Company that provides the commercial financing to a Recipient, a Provider that is not a Finance Company generally does not conduct an underwriting of the Recipient's business. In many cases, a non-Finance Company Provider simply obtains an application from a Recipient and forwards that to a Finance Company. The Finance Company then requests more detailed financial documentation directly from the Recipient. Later, the non-Finance Company Provider may present an offer for commercial financing to the recipient based on the information the Finance Company has obtained. However, the non-Finance Company Provider is not given access to that information and would be unable to calculate an estimated monthly sales or receipts projection pursuant to Section 2091. We recommend this Section be revised to account for transactions where a non-Finance Company Provider does not have access to the financial information necessary to calculate an estimated monthly sales or receipts projection.

2. Historical Data For Sales or Receipts Projections

Commercial Finance Companies use a variety of information when evaluating the projected monthly sales/receipts of a Recipient, especially Finance Companies in the alternative small business finance industry. In addition to the historical sales or income data provided by Recipients, Finance Companies rely on publicly available sources of information, third-party data vendors and internal data sources to model the anticipated revenue of their customers. However, Subdivision 2091(b)(1) prohibits these Finance Companies from utilizing these valuable sources of information. Instead, the Regulations would require a Finance Company's projection to be based solely on the historical revenue data of the Recipient despite the fact this information is often not wholly determinative of a Recipient's future revenue and, in many cases, will not result in accurate projections of future receipts. We recommend that this Section be revised to permit Finance Companies to utilize other sources of information when using the historical method to determine a monthly sales or receipts projection.

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

1. Internally Estimated Sales Projection

In many commercial financing transactions, a Provider will not have access to the information necessary to calculate an internal estimated sales projection. Please see our related comments in paragraph 1 to our comments to Section 2091.

2. Early Payoffs and Refinancing

The audit process detailed in Subdivision 2092(d) requires the Provider to treat an account paid off during the normal course the same as an account that is voluntarily paid off early by the customer or refinanced. The voluntary early repayment of these accounts will result in their retrospective annual percentage rate to vary materially from the rate disclosed at the time the transaction was consummated. These variances are outside of the Providers control and it is not reasonable to conclude the calculations and disclosures provided were insufficient because of these voluntary actions by the customer. We recommend transactions paid off prior to the end of the expected term be excluded from the audit process.

§ 3000. Annualized Rate Disclosure.

In section, 3001(h), the word "calculated" should be "calculate."

§ 3001. Calculation of Annual Percentage Rate.

1. Appendix J, 12. C.F.R. PART 1026 Applies to Closed-end Credit Only

Subdivision 3001(a) requires the APR to be calculated in accordance with Appendix J, 12 C.F.R. Part 1026. However, this section is the APR calculation for closed-end credit only. As such, the Regulations require a closed-end credit calculation for open-end programs and non-credit transactions. The requirement that a mathematical calculation be used for transactions for which it was not designed is per se confusing and seems likely to result in a deceptive disclosure regime.

2. Payment Days vs. Calendar Days

Subdivision 3001(g) provides that when calculating an APR, a Provider may assume it can collect payments on every calendar day regardless of the actual collections days. The language could be read to permit a Provider to just take the daily payment amount they receive each payment day and assume that amount is paid each calendar day (which leads to a massive increase in the finance charge). We suspect this was not the intent but if it was, this creates a material issue as the APR would be severely overstated (by about 100%). No Provider would ever want to use this calculation assumption. If the intent was to permit the total of payments to be divided by the total calendar days instead of the payment days (we assume this was the intent), that should be made clear. The provision also creates confusion as it seems to apply only to APRs and not

Estimated APRs as it only refers to APRs and never references Estimated APRs. Under the Regulations it appears that an estimated APR is a unique disclosure and is not a subset of APR.

3. Variable and Benchmark Rates

Subdivision 3001(h) applies to variable rate transactions. However, the language is confusing. For example, it applies only if the variable rate is calculated based on a benchmark rate plus margin. However, variable rates can be based on changes not related to a benchmark or margin. Additionally, the definition of benchmark rate is so limited under the Regulations it would be easy to structure a variable rate product that would not be subject to these provisions. Furthermore, the last phrase in this subdivision is confusing. This language makes it unclear if the Regulations require an initial rate to be disclosed as well as another rate, if an initial rate should be ignored, or if an initial rate and subsequent rate must be averaged. Finally, this subdivision refers to "interest charge" but that term is did not defined anywhere (it would be clearer to refer to a finance charge imposed as a result of the application of a rate to an outstanding balance).

4. Spelling/Grammatical Errors

In section 3001(h), the word "calculated" should be "calculate."

§ 3002. Calculation of Annual Percentage Rate – Factoring Transactions

1. APR for Account Factoring Transactions Where Multiple Accounts Are Sold

As discussed in Paragraph 1 of our comments to Section 2063, the Regulations do not address factoring transactions where multiple accounts are sold at the same time. Subdivision 3002(a) provides for the calculation of the annual percentage for a factoring transaction "based upon a single transaction…" and Subdivision 3002(b) provides the calculation of the annual percentage rate for an example transaction pursuant to Section 22803. Nothing in Section 3002, or any other section of the Regulations, explain how to calculate an annual percentage for a factoring transaction where multiple accounts are sold at the same time. It is also unclear if the annual rate disclosure required for such a transaction would include multiple rate disclosures for each account sold or if the disclosed rate would be a straight or weighted average of the individual accounts sold. We recommend the Regulations provide guidance on this issue given how commonly it occurs in factoring transactions.

2. Spelling/Grammatical Errors

Subdivision 3002(a) – cites "section 22802, subdivision (a)(6) of the Code…." There is no subdivision (a)(6) of Section 22802. The correct citation is "section 22802, subdivision (b)(6) of the Code…."

§ 3003. Estimates Annual Percentage Rate – Sales-based financing

In 3003(c), the word "calculated" should be "calculating."

§ 3010. Finance Charge.

Section 3010 defines Finance Charge as all charges included in the Finance Charge under 12 C.F.R. § 1026.4 (assuming the transaction is a consumer credit transaction). However, adopting this language from Regulation Z language is simply not adequate to address the commercial transactions subject to the Regulations. For example, 12 C.F.R. § 1026.4(a) provides that a finance charge is a fee "imposed by a creditor" as "a condition of the extension of credit." Many of the companies subject to the Regulations are not creditors under Regulation Z and many of the products subject to the Regulation are not "extensions of credit" (the products do not include a right to defer payment for a debt). For example, an entity providing lease financing is not a creditor under Regulation Z and a lease transaction is not a credit transaction under Regulation Z. Therefore, any fees imposed by a leasing company as part of a lease transaction are not finance charges as defined in the Regulations. The same result would occur for MCAs, account factoring and other transactions subject to the Regulations. Clearly, this is not what is intended but it highlights why borrowing specific language from Regulation Z and attempting to make that language apply to transactions not subject to Regulation Z is an enormous task that is riddled with potential errors, loopholes and problems.

§ 3020. Asset-based lending; General disclosure requirements.

Section 3020 states that an asset-based lending Provider may provide an alternative disclosure permitted by Section 22803 rather than the disclosure requirements under Section 2063. However, Section 2063 details disclosure requirements for factoring transactions pursuant to Section 22802. As such, it is unclear why or how an asset-based lending Provider would be permitted to provide disclosures pursuant to Section 2063. Rather, it appears the reference to Section 2063 was in error. However, there is no Section to which the reference would be correct as the Regulations fail to provide disclosure requirements for asset-based lending transactions made pursuant to Section 22802 to which the disclosure requirements of Section 3020 would be an alternative.

§ 3021. Asset-based lending; Example transaction.

1. Erroneous Section Reference

   Section 3021 states that the alternative disclosure given by an asset-based lending Provider based on an example transaction must be made in accordance with the formatting requirements of Section 2064. However, Section 2064 details requirements for disclosures made pursuant to Section 22803 for factoring transactions not asset-based lending transactions. The reference to Section 2064 is erroneous; the correct reference would be to Section 2067.

2. Provider vs. Finance Company

   Subdivision 3021(b) states that "[i]f the agreement between a provider and recipient does not specify a maximum credit amount, the example transaction used in making the disclosures shall assume the recipient has drawn $10,000." The term "provider" should be changed to "finance company."

§ 3022. Factoring; Example Transaction.

Subdivision 3022(c) states that "[i]f 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." The term "provider" should be changed to "finance company."

IV. CONCLUSION

We appreciate the Commissioner's effort to draft the Regulations. However, based on all the above, we believe the Regulations are simply unworkable and will create confusion for small businesses and Providers. Disclosure laws have a history of creating massive liability for Finance Companies even in cases where the disclosures were provided with the best of intentions and efforts. TILA and Regulation Z are expansive (taking up hundreds of pages) and all of that detail is necessary to address the various issues raised by the required disclosures. Regulation Z and its disclosures were drafted after years of debate and consumer testing and that debate and testing continues with revisions occurring every few years. It is simply not possible for the Commissioner to take an even more complicated statute than TILA (SB 1235 is significantly more complicated as it applies to a much wider range of transactions) and attempt to address the enormous issues created in 33 pages of regulations with no customer testing, much more limited staffing than at the federal level, fewer resources, and a statute that provides even less guidance. Trying to force TILA disclosures to apply in these circumstances is the equivalent of forcing a square peg in a round hole.

We suggest the Commissioner not rely on a federal law that was never meant to apply to business transactions, lease transactions, factoring transactions, or purchase transactions. Rather, proceed with a new disclosure measure that is easily defined, easily calculated and easily understood. While we believe ACC is capable of doing this, please note that SB 1235 does not limit you to only APR or ACC. You can clearly devise another metric. We believe the following principles may be helpful to consider in a revised Regulation:

1. The broad transaction definitions under SB 1235 are much easier to follow than the highly detailed, prescriptive and sometimes inconsistent definitions in the Regulations.

2. Don't borrow provisions from Regulation Z as doing so creates confusion. Regulation Z is highly technical and definitions often rely on other definitions. Without expressly addressing all the provisions of Regulation Z that would be impacted by the Regulations if Regulation Z was incorporated, it will be impossible to create a disclosure regime that works.

3. Simplicity helps as highly complicated language and mathematical calculations will create liability for Providers and misleading disclosures for small businesses.

4. A methodical introduction of new disclosures for commercial finance will better serve Recipients and Providers than attempting to draft an entire regulatory regime in one iteration. TILA and its implementing regulations are the work of decades of legislative and regulatory review, drafting and redrafting. Given the complexity of the issues involved, an incremental approach where regulations are introduced in stages, over time would be advisable.

5. Trying to account for the time value of money in an annualized disclosure will prove difficult for no real value. APR was created at a time when interest rates for secure transactions like mortgages were around 10% and rising to the middle teens. Unsecured rates were much higher. The time value concept was more useful then. It was also more useful in the 1970s as most consumer credit transactions at the time were multiple year transactions – not short term transactions. While the APR is still required in consumer credit transactions today, it was created at a different time when different issues existed. The fact the federal regulators have concluded APR is seldom used by consumers when shopping for credit is all the proof that is needed to establish that APRs are outdated. Federal regulators have reduced the importance of APR, removed

actual APRs from some disclosures (*e.g.*, credit cards), and moved APRs to the back page of some disclosures (mortgages).

6. It is not that difficult to accomplish the original goals of APR with a different disclosure. The goal is to enable customers to evaluate the relative costs of products. Neither businesses nor consumers view the time price value of money as material when a transaction is for a few years or less and interest rates are low. In business transactions, the time value concept is even less important as the business is more concerned with how much it can make with money it gets from a Finance Company than the time value impact of the payment stream. Ignoring the time value component for the annualized rate will simplify the calculation, result in the calculation that most consumers and business actually use themselves when assessing cost (none of them attempt to account for the time value concept) and provides a relative comparison point for costs.

7. Customers simply will not rely on APRs given how confusing they are. Whether Providers of business financing are required to disclose a high rate or lower rate will not matter. It is simply the broad relevant cost they want to know as other terms are way more important in business financing (how fast can they get the funds, who has to guarantee the transaction, what are the repayment terms, what is the dollar amount the financing will cost).

Thank you for considering our comments. We remain committed to working with you to implement regulations that provide value to small businesses. We hope you appreciate the detail of our letter and recognize that it exhibits our commitment to working with you to make sure the final regulations work and provide value. We would be happy to discuss these matters in person or by telephone. You may reach me at 240-482-4684.

Very truly yours,

[redacted]

Joseph D. Looney
General Counsel

EXHIBIT A

§ 2057. Definitions.

§ 2060. General Formatting and Content Requirements.

§ 2061 Closed-End Transaction Formatting and Content Requirements.

§ 2062. Commercial Open-Ended Credit Plan Disclosure Formatting.

§ 2063. Factoring Disclosure Format

§ 2064. General Factoring Disclosure Format

§ 2065. Sales-Based Financing Disclosure Formatting

§ 2066. Formatting and Content Requirements for Lease Financing.

§ 2067 General Asset-Based Lending Transaction Disclosure Formatting.

§ 2070. Signatures.

§ 2071. Thresholds for Disclosures

§ 2089. Closed-end/Open-end Credit Plans with Payment Options.

§ 2090. Estimated Term and APR – Factoring Transactions

§ 2091. Estimates – Accounts Receivable Purchase Transactions/Asset-Based Lending Transactions – Historical Method.

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

§ 3000. Annualized Rate Disclosure.

§ 3001. Calculation of Annual Percentage Rate.

§ 3002. Calculation of Annual Percentage Rate – Factoring Transactions

§ 3003. Estimates Annual Percentage Rate – Sales-based financing

§ 3010. Finance Charge.

§ 3020. Asset-based lending; General disclosure requirements.

§ 3021. Asset-based lending; Example transaction.

§ 3022. Factoring; Example Transaction.

Submitted by Electronic mail to: regulations@dbo.ca.gov and [redacted]@dbo.ca.gov

January 30, 2020

Department of Business Oversight, Legal Division
Attn: Rulemaking Coordinator
1515 K Street, Suite 200
Sacramento, CA 95814-4052

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

Dear Commissioner Alvarez,

Small Business Financial Solutions, LLC dba RapidAdvance ("RapidAdvance") would like to thank the Department of Business Oversight ("DBO") for once again reaching out to stakeholders and inviting them to provide input on the above referenced rulemaking. RapidAdvance appreciates that the DBO has continued to invite industry participants ("Providers") to submit their thoughts and comments.

Rapid Finance previously provided two in-depth comments detailing why the draft regulations and sample disclosures ("Regulations") create a broad range of issues. In both of our previous comments we provided a great deal of information regarding APRs and the problems with the use of APRs for the transactions subject to new Division 9.5 of the Financial Code (the "Code"). We request that our initial letters be reviewed again as they contain extensive information regarding the use of APR and its impact on businesses.

We appreciate the DBO's request for information on this most recent Invitation. Below we provide responses only to the questions where we can provide specific information.

I. OUR COMPANY

RapidAdvance provides working capital to small businesses throughout the United States and operates as a licensed Finance Lender in California. RapidAdvance and its affiliates have been providing funding to small businesses for more than a decade and the majority of our customers have grown to become thriving businesses. Our financing products include merchant cash advances ("MCAs") and business loans. MCAs allow small retail businesses to sell their future card sales in exchange for immediate working capital (the transaction is a purchase and sale rather than a loan). The receivables we purchase are delivered to us whenever the merchant batches out its credit card terminal and forwards to us the percentage of funds that we purchased.

Our small business loan is similar to a traditional commercial loan with two primary differences. First, the borrower makes daily or weekly payments rather than monthly payments. Second, our loans charge a fixed fee rather than an interest rate. A fixed fee allows our customers to easily determine the actual dollar amount the loan will cost and the more frequent payment schedule ensures the business is not overwhelmed by large monthly payments. Our underwriting model allows us to fund businesses that traditional lenders turn away and permits us to offer financing solutions to businesses whose growth is constrained by their ability to access capital. Our customers that qualify for both the loan product and the MCA can choose the product that best fits their needs.

The customers that use our financing products include almost every type of small and medium sized business in America. Our customers' annual revenue generally ranges from $250,000 to $4,000,000. The average funding we provide is about $50,000. Approximately 90% of our customers are limited liability companies or corporations. The online small business finance industry now originates more than $15 billion annually and the overwhelming majority of small businesses that have obtained financing from industry participants prefer our products and process over traditional financing sources.

II. SPECIFIC COMMENTS

A. <u>The advantages, disadvantages and benefits for businesses as a result of the Regulations</u>

Small Businesses deserve to receive disclosures when applying for small business financing. While the majority of financing companies in the industry are currently providing variations of the disclosures required by SB 1235, there are some actors that are not providing any disclosures or are providing misleading disclosures. SB 1235 will help to insure that all financing companies are providing disclosures to assist the small business in making an informed decision. This will allow all small businesses looking for financing that is subject to SB 1235 to be on a level playing field with other small businesses and insure that small businesses are making informed decisions.

We agree that it is in the small businesses' and in turn the welfare of the community's best interest to receive disclosures prior to entering into a business financing; however, over-disclosure, irrelevant disclosures or misleading disclosures harm small businesses and can often encourage a small business to take more expensive financing, go out of business and negatively affect the welfare of the community. As we have stated in our previous comments, requiring an APR disclosure, the lack of clarity in the definitions throughout the proposed Regulations, along with requiring additional disclosures that are outside the scope of SB 1235 will only harm small businesses and have a negative impact.

1. <u>Adopting APR from Regulation Z</u>
   APR was not intended to provide an apples to apples comparison across all types of financing products. The Truth and Lending Act ("TILA") calculates the APR

differently for open-end and closed-end credit and even certain closed-end credit transactions calculate APRs differently. These differences are due in large part to what types of fees are included in the calculation (*e.g.* mortgage loan APR calculation might exclude a fee that an automobile loan includes). Requiring an APR disclosure that is universally known as a lending or credit sale disclosure will be misleading for the types of products covered by the Regulations. APR will be even more confusing in the business financing industry as payment terms are so unique. APR can be misleading for many of the more innovative products that provide more frequent payments or unique repayment features. For example, two products with identical pricing and terms will have different APRs if one is a monthly payment product and one is a daily payment product. In fact, a monthly product can be materially more expensive on a dollar basis than a daily pay product but still have a lower APR. This can lead a small business to believe a product is cheaper when in fact the product is more expensive. This will put a small business at a disadvantage as that small business might be paying for a more expensive product compared to another small business. Additionally, requiring rate disclosures typically used for loans (such as APR) to be used for non-loan products (MCAs, factoring, leasing, etc.) will create massive confusion. APR has never been imposed on consumer purchase and sale transactions (in fact such transactions are expressly excluded from TILA). It is impossible to calculate even an implied rate for purchase and sale transactions because there is no fixed term or accruing rate. Because purchase transactions do not require specific amounts to be paid at a designated frequency, the term for these products cannot be calculated until after the transaction has concluded. Without a known term, only an estimated term and rate can be provided, which means the annualized rate and term disclosed will be, by definition, incorrect and misleading. We would recommend deleting the APR disclosure from the Regulations.

2. Additional Disclosures and Lack of Clarity
   The Regulations created an "Estimated Monthly Cost" disclosure that is not a required disclosure under SB 1235 nor was ever contemplated by the author. Not only is it outside the scope of SB 1235, an Estimated Monthly Cost frustrates the intended purpose of SB 1235 as it detracts from other more meaningful disclosures and may confuse small businesses. Over-disclosure puts small businesses at a disadvantage. Moreover, certain sections of the Regulations are confusing and it is uncertain as to what type of financing they are referring to and make it difficult for the financing company to comply because the company might not know which disclosures to provide. Lastly, there are multiple times where undefined terms are used and inconsistent terms are used. The Regulations are not clear and will cause

confusion not only to the financing companies but to the small businesses that are provided with the disclosures.

B. Incentives for innovations

Once again, we believe disclosures are important and a good thing; however, prescriptive disclosures and ones that try to fit a myriad of products into a couple of categories is counterproductive to innovation. As you are aware, there are currently multiple types of commercial financing (i.e. MCAs, loans, lines of credits, factoring, equipment leasing) and not all of them are structured the same way or can fit under the same type of disclosures. Currently there are issues with the Regulations as to how to calculate APR effectively and accurately and what categories cover which types of financing products. If these issues are present with known products, the Regulations will certainly have a negative impact of products developed in the future. If the Regulations are not fluid or try to require potential new products to fit within the confines of the Regulations, especially APR, then financing companies are less likely to innovate, which would in turn hurt small businesses, because financing could cease or not evolve with the changing landscape. In the alternative, financing companies will continue to innovate and could potentially create an amazing new product, but because using the disclosures from the Regulations would be misleading or would not fit the product, the companies may offer the product in other states but not in California We believe the Regulations should have enough disclosures to inform small businesses of the cost of the financing, but not so much that it will stop companies from innovating or offering certain beneficial products to California small businesses.

C. Possible alternatives to the requirements imposed by the Regulations

As we have mentioned in our prior comments, Congress recognizes the APR is insufficient and does not serve its intended purpose. In response to this, the Dodd-Frank Act amended TILA to require a new rate disclosure for mortgages - the Total Interest Percentage ("TIP"), which is simply the total amount of interest that the consumer will pay over the life of the loan expressed as a percentage (*e.g.,* a $100,000 mortgage loan with $50,000 of interest over the life of the loan would have a TIP of 50%). *See* Dodd-Frank Wall Street Reform and Consumer Protection Act § 1419(19). The TIP disclosure is an attempt to provide information to consumers that is more useful than APR, easier to understand and easier for creditors to calculate. We believe that the TIP or even the Annualized Cost of Capital ("ACC") that we prosed on our previous comment letters are a significantly better alternatives to APR.

If the goal of SB 1235 and the Regulations is provide the small businesses with a metric to have an apples to apples comparison between products and also to have all of the information communicated in a way that is meaningful and easy to understand, then APR is not a useful metric. Why would providers want to provide a metric to small businesses that is not understood and causes confusion? When APR was first introduced, it was a new untested metric for consumer products, but appeared to solve an issue even if the average person cannot calculate it. Years later it has been proven not to be an effective metric.

Based on the aforementioned, we truly believe that TIP and ACC are better alternatives to APR.

III. CONCLUSION

Thank you once again for considering our comments. We remain committed to working with you to implement regulations that provide value to small businesses. We hope you appreciate all of our letters and recognize that they exhibits our commitment to working with you to make sure the final regulations work, provide value and assist small businesses. We would be happy to discuss these matters in person or by telephone. You may reach me at 240-482-4684.

Very truly yours,

[redacted]

Joseph D. Looney
General Counsel

EXHIBIT B

Exhibit B

OFFER SUMMARY

Funding You Will Receive	$24,000.00	The amount of money we will wire you is $24,000.00. You are selling $58,000.00 of your card receivables to us for $50,000.00. A discount of approximately 13.7931%. From the $50,000.00 we are deducting the following amounts: $3,000.00 to pay off your balance to Business Lenders Group, LLC; $2,000.00 to pay off your balance to Business Cash, LLC; $1,500.00 to pay off your balance to Capital Funding, LLC; $1,500 to pay off your balance to Opportunity Fund Express, LLC; $7,000.00 to pay off your existing balance with us; $1,200.00 to pay off your state tax liens with the Maryland Department of Assessments and Taxation; $1,300.00 to pay off your state tax liens with the Massachusetts Department of Revenue; $500.00 to pay off your state tax liens with the Florida Department of Revenue; $4,000.00 to pay off your tax liens with the Internal Revenue Service of the United States Department of Treasury; $2,500.00 to pay off your past due rent to your business landlord, Rental Properties 123, LLC; $1,500.00 to pay off your outstanding licensing fee with the State of Maryland Board of Liquor License Commissioners for Baltimore City.

Exhibit B

		This is a total of $26,000.00 in deductions. This will result in $24,000.00 being wired to you from us.
Estimated Annual Percentage Rate (APR)	40.4%	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 your card processor will be $98,531.71. APR it is not an interest rate. The amount of the finance charge you will pay is not based upon an interest rate.
Estimated Finance Charge	$8,000.00	The Estimated Finance Charge is calculated by multiplying the total value of the receivables you are selling us by approximately 86.2069% and then subtracting that amount from the total value of the receivables you are selling us. This results in an amount of $8,000.00. The actual calculation is $58,000.00 x 86.2069% = $50,000.00. $58,000.00 minus $50,000.00 = $8,000.00. If you subtract the $8,000.00 from the $58,000.00 in receivables you are selling, you get the $50,000.00 we are providing you. You then add to the $8,000.00 in estimated finance charges any origination and processing fees we may charge you. In

Exhibit B

		this case we are not charging any such fees. Your finance charge will not increase if you take longer to pay off what you owe.
Estimated Monthly Cost	$6,897.22	Although you do not make payments on a monthly basis, this is our calculation of your average monthly cost. This is the total amount you will pay us on average each month until your transaction is complete.
Estimated Payment	$313.51/per business day.	
Payment Terms	Each business day when banks are open, your credit card processor will remit your gross card receipts to a lockbox account in your name and approved by us. The lockbox provider will then send us 7% of each deposit and the remaining amount will be forwarded directly to you. The lockbox provider may charge you fees to maintain the lockbox account. Please review the lockbox agreement for applicable term and fees.	
Estimated Term	0 years 9 months	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 $98,531.71 in monthly revenue through your card processor.
Prepayment	If you pay off the financing faster than required, you will be required to pay all or a portion of the estimated finance charge, up to $8,000.00 based upon our estimates.	
	If you pay off the financing faster than required, you will not be required to pay additional fees not already included in the estimated finance charge.	

California law requires this information to be provided to you to help make an informed decision. By signing below, you are confirming that you received this information.

Recipient Signature Date

EXHIBIT C

Exhibit C

OFFER SUMMARY

Funding You Will Receive	$24,000.00	The amount of money we will wire you is $24,000.00. You are selling $58,000.00 of your card receivables to us for $50,000.00. A discount of approximately 13.7931%. From the $50,000.00 we are deducting the following amounts: 1. $3,000.00 to pay off your balance to Business Lenders Group, LLC; 2. $2,000.00 to pay off your balance to Business Cash, LLC; 3. $1,500.00 to pay off your balance to Capital Funding, LLC; 4. $1,500.00 to pay off your balance to Opportunity Fund Express, LLC; 5. $7,000.00 to pay off your existing balance with us. 6. $1,200.00 to pay off your state tax liens with the Maryland Department of Assessments and Taxation; 7. $1,300.00 to pay off your state tax liens with the

		Massachusetts Department of Revenue; 8. $500.00 to pay off your state tax liens with the Florida Department of Revenue; 9. $4,000.00 to pay off your tax liens with the Internal Revenue Service of the United States Department of Treasury; 10. $2,500.00 to pay off your past due rent with your business landlord, Rental Properties 123, LLC; 11. $1,500.00 to pay off your outstanding licensing fee with the State of Maryland Board of Liquor License Commissioners for Baltimore City. This is a total of $26,000.00 in deductions. This will result in $24,000.00 being wired to you from us.
Estimated Annual Percentage Rate (APR)	40.4%	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

Exhibit C

		estimated monthly income through your card processor will be $98,531.71. APR it is not an interest rate. The amount of the finance charge you will pay is not based upon an interest rate.
Estimated Finance Charge	$8,000.00	The Estimated Finance Charge is calculated by multiplying the total value of the receivables you are selling us by approximately 86.2069% and then subtracting that amount from the total value of the receivables you are selling us. This results in an amount of $8,000.00. The actual calculation is $58,000.00 x 86.2069% = $50,000.00. $58,000.00 minus $50,000.00 = $8,000.00. If you subtract the $8,000.00 from the $58,000.00 in receivables you are selling, you get the $50,000.00 we are providing you. You then add to the $8,000.00 in estimated finance charges any origination and processing fees we may charge you. In this case we are not charging any such fees. Your finance charge will not increase if you take longer to pay off what you owe.
Estimated Monthly Cost	$6,897.22	Although you do not make payments on a monthly basis, this is our calculation of your average monthly cost. This is the total amount you will pay us on average each month

Exhibit C

		until your transaction is complete.
Estimated Payment	$313.51/per business day	
Payment Terms	Each business day when banks are open, your credit card processor will remit your gross card receipts to a lockbox account in your name and approved by us. The lockbox provider will then send us 7% of each deposit and the remaining amount will be forwarded directly to you. The lockbox provider may charge you fees to maintain the lockbox account. Please review the lockbox agreement for applicable term and fees.	
Estimated Term	0 years 9 months	This is not an exact term because this is Sales-Based Financing and not a closed-end transaction. This may or may not be the exact length of time for how long it will take for you to pay your Sales-Based Financing in full. 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 $98,531.71 in monthly income through your card processor. This is just an estimated length of time. You may complete your contract obligations faster than this or slower than this.
Prepayment	If you pay off the financing faster than required, you will be required to pay all or a portion of the estimated finance charge, up to $8,000.00 based upon our estimates. If you pay off the financing faster than required, you will not be required to pay additional fees not already included in the estimated finance charge.	

Exhibit C

California law requires this information to be provided to you to help make an informed decision. By signing below, you are confirming that you received this information.

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Recipient Signature Date

EXHIBIT D

Exhibit D

OFFER SUMMARY

Funding You Will Receive	Twenty-Four Thousand Dollars	The amount of money we will wire you is twenty-four thousand dollars. You are selling fifty-eight thousand dollars of your card receivables to us at a discount of approximately thirteen point seven nine three one percent. From the fifty thousand dollars we are deducting the following amounts: three thousand dollars to pay off your balance to Business Lenders Group, Limited Liability Company; two thousand dollars to pay off your balance to Business Cash Limited Liability Company; one thousand five hundred dollars to pay off you balance to Capital Funding Limited Liability Company; fifteen hundred dollars to pay off you balance to Opportunity Fund Express Limited Liability Company; seven thousand dollars to pay off your existing balance with us; one thousand two hundred dollars to pay off your state tax lien with the Maryland Department of Assessments and

Exhibit D

Taxation; one thousand three hundred to pay off your state tax lien with the Massachusetts Department of Revenue; five hundred dollars to pay off your state tax liens with the Florida Department of Revenue; four thousand dollars to pay off your outstanding tax liens with the Internal Revenue Service of the United States Department of Treasury; two thousand five hundred dollars to pay you’re your past due rent with your business landlord, Rental Properties 123, LLC; one thousand five hundred dollars to pay off your outstanding licensing fee with the State of Maryland Board of Liquor License Commissioners for Baltimore City.

The aforementioned is a total of twenty six thousand dollars in deductions.

After all of these deductions you will receive a total of twenty four thousand dollars in your business bank account.

Exhibit D

Estimated Annual Percentage Rate (APR)	Forty Point Forty Percent	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 your card processor statements will be ninety-eight thousand five hundred thirty-one dollars and seventy-one cents.
Estimated Finance Charge	Eight Thousand Dollars	The Estimated Finance Charge is calculated by multiplying the total value of the receivables you are selling us by approximately eighty-six point two zero six nine percent and then subtracting that amount from the total value of the receivables you are selling us. This results in an amount of eight thousand dollars. The actual calculation is fifty eight thousand dollars multiplied by eighty six point two zero six nine percent equals fifty thousand dollars. Fifty eight thousand dollars minus fifty thousand

Exhibit D

		dollars equals eight thousand dollars. If you subtract the eight thousand dollars from the fifty-eight thousand dollars in receivables you are selling, you get the fifty thousand dollars we are providing you. You then add to the eight thousand dollars in estimated finance charges any origination and processing fees we may charge you. In this case we are not charging any such fees. Your finance charge will not increase if you take longer to pay off what you owe.
Estimated Monthly Cost	Six Thousand Eight Hundred Ninety-Seven Dollars and Twenty- Two Cents	Although you do not make payments on a monthly basis, this is our calculation of your average monthly cost. In order to calculate this amount we are estimating this on the average amount you are processing each month until your transaction is complete. This will give us the estimated amount per month that you will be paying.
Estimated Payment	Three Hundred Thirteen Dollars and Fifty-One Cents /per business day	

Exhibit D

Payment Terms	Each business day when banks are open, your credit card processor will remit your gross card receipts to a lockbox account in your name and approved by us. The lockbox provider will then send us Seven Percent of each deposit and the remaining amount will be forwarded directly to you. The lockbox provider may charge fees and fees may be deducted to maintain the lockbox account. Please review the lockbox agreement for applicable term and fees.	
Estimated Term	Zero Years and Nine Months	This is not an exact term because this is Sales-Based Financing and not a closed-end transaction. This may or may not be the exact length of time for how long it will take for you to pay your Sales-Based Financing in full. 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 Ninety-Eight Thousand Five Hundred Thirty-One Dollars and Seventy-One Cents in monthly revenue through your card processor. This is just an estimated length of time. You may complete your contract obligations faster than this or slower than this.
Prepayment	If you pay off the financing faster than required, you will be required to pay all or a portion of the estimated finance charge, up to eight thousand dollars based upon our estimates. For example, if you decide to pay the sales-based financing off on day two of your payments, you would pay the full amount.	

Exhibit D

If you pay off the financing faster than required, you will not be required to pay additional fees not already included in the estimated finance charge.

California law requires this information to be provided to you to help make an informed decision. By signing below, you are confirming that you received this information.

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Recipient Signature Date

EXHIBIT E

Exhibit E

OFFER SUMMARY FOR SALES-BASED FINANCING

Funding You Will Receive	$50,000.00	This is the amount of the financing that you will receive excluding any deductions. After deductions, you will receive $24,000.00. (For an itemization of the deductions, see below).
Estimated Finance Charge	$8,000.00	The Estimated Finance Charge is what the financing will cost. Your finance charge will not increase if you take longer to pay off what you owe.
Estimated Annual Percentage Rate (APR)	40.4%	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 your card processor will be $98,531.71. APR it is not an interest rate. The amount of the finance charge you will pay is not based upon an interest rate.
Total Payback Amount	$58,000.00	This is the total amount you will pay back.
Estimated Payment	$313.51/per business day.	
Payment Terms	You will pay us each business day banks are open and you process credit cards. You will send to us 7% of your daily card sales.	
Estimated Term	9 months	This is our estimate of how long it will take you to complete your contractual obligations.
Prepayment	You will pay the total estimated finance charges above even if you pay off the transaction early. There is no discount for prepayment. If you do pay off early, there are no additional fees imposed.	

Itemization of Deductions from the Funding You Will Receive:

1. $8,000.00 to pay-off your balances with other providers
2. $7,000.00 to pay-off your existing balance with us
3. $3,000.00 to pay-off your state tax liens
4. $4,000.00 to pay-off your federal (IRS) tax lien
5. $2,500.00 to pay-off your past due rent with your landlord
6. $1,500.00 to pay-off your balance with the Baltimore City Liquor License Board

Total deductions = $26,000.

California law requires this information to be provided to you to help make an informed decision. By signing below, you are confirming that you received this information.

________________________________ __________________

Recipient Signature Date