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October 28, 2020

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

California Department of Business Oversight to the Department of Financial Protection and Innovation (DFPI)
Attn: Charles Carriere, Senior Counsel
One Sansome Street
Suite 600
Sacramento, CA 94104-448

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

Dear Commissioner Alvarez,

Rewards Network Establishment Services Inc. ("Rewards Network") would like to thank the California Department of Financial Protection and Innovation ("DFPI") for this opportunity to provide input on the above proposed regulations ("Regulations"). While this is Rewards Network's first submission to this office on this topic, we understand that many industry groups and leading providers of small business financing options have previously provided comment on a broad range of issues. Rewards Network is happy to add our voice to the discussion as we work towards final rules, and we respectfully request that you read this comment letter in conjunction with those supplied by our industry peers. Of particular note are previously submitted comments from RapidAdvance on the topic of annual percentage rates ("APR") and the issues created by new Division 9.5 of the Financial Code (the "Code") relating to sales-based financing, which we respectfully request the commissioner review along with this round of comments.

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I. OUR COMPANY

Rewards Network provides working capital to local restaurants located throughout California and the United States. Rewards Network has provided local restaurant funding for more than two decades. Our financing product is a merchant cash advance ("MCAs"), which allows small independent restaurants 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 that includes a true-up mechanism or a fixed payment amount (each payment truly varies based on the split rate). Perhaps at no other time in our history as a company has the value of an MCA been more apparent to our customers, and more easily discernable from a loan product, than during the pandemic. Rrestaurants that have been forced to close – either temporarily or permanently – have seen a cessation of the delivery of purchased receivables (as none were generated in the normal course of business). This flexible financing product has brought peace of mind to our restaurant partners during otherwise incredibly difficult times.

II. COMMENTS

A. General Formatting and Contents

In order to insure that 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 the same.

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Although § 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 have not been addressed that need to be addressed in order for 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." 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.

(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 virtually every other disclosure law in the country).

(iii) 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 it consumes multiple pages (less likely a small business will read through multiple pages). For consistency, the Regulations should be amended to

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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 Offer Summary (which could be larger). A 20 point font would satisfy the "clear and conspicuous" requirement but make the disclosures meaningless as they would take up 5 or more pages.

(iv) The 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 that must be disclosed be disclosed in numeric value.

(v) Lastly, the proposed Regulations permit various descriptions to be included with no restrictions. This could lead to descriptions dominating the disclosures and making them worthless. The descriptions could easily force the disclosures to span multiple 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 truly allow potential clients the opportunity to perform an apples to apples comparison of financing options. Additionally, we have the following suggested edits to the current language used in § 2060:

(i) § 2060(a)(9)(A) [1] refers to the "best information reasonable available." Disclosure laws generally avoid requirements for things such as best available as such words creates unneeded litigation risk. Whether something is the

[1] 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.

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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) § 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, 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 that providers be required to disclose just the number of months (to the nearest two decimal places) or the total number of days. For terms of a year or more, the current wording in the proposed Regulation is sufficient.

(iii) § 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 the proposed Regulations seem to intend for it to mean .1% (1/10th of a percent) (*e.g.* 19.6%). 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 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 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.

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B. Specific Disclosure Forms

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 we request are addressed in order for the disclosures to be accurate and meaningful. Note that we only address these issues in the context of sales-based financing transactions as an MCA is the only product we offer as of this date:

(i) Row Five: Row Five Column Two/Three states that the provider must disclose the estimated payment or if there are periodic payments, than the provider must list the periodic payments. 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. In this situation, all that can be disclosed is an assumed payment amount based on the estimated terms and the applicable calculations required under the proposed Regulations. The requirement to list the estimated periodic payments is simply not possible. There is no way to tell ahead of time what those daily variable payments would be as it is based on the recipient's sales. It is critical that this issue is addressed. We suggest you 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 estimated payment. This would be consistent with DPFI's draft disclosure from provided in a previous Invitation as it did not include the disclosure of all possible daily payment amounts.

C. ESTIMATES – SALES BASED FINANCING (ACCOUNTS RECEIVABLE PURCHASE TRANSACTIONS) – HISTORICAL METHOD

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

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why this "one size fits all" approach is being mandated. If a business operates in a seasonal market, for instance, 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, a non-seasonal business (by way of example and not limitations) does not wat to nor does it expect 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 as follows: allow business to adopt common-sense practices regarding the collection of statements, and require that they disclose the reasons for requiring the number of statements they require to the applicant.

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, business 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 has 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 four months if that customer renews with them (or perhaps zero months). 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.

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D. ANNUALIZED RATE DISCLOSURE

Section 3000 simply requires providers to disclose an APR when making a specific offer of commercial financing. It is unclear why this section is necessary. 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.

E. CALCUATION OF ANNUAL PERCENTAGE RATE

As others have argued in previous submissions on this topic, we do not believe APR is the best metric and will actually cause more confusion. We incorporate prior comments provided to you by RapidAdvance and the Small Business Finance Association into this letter as they specifically relate to sales-based financing transactions. More specifically, we are concerned that the adoption of an APR-based calculation for an MCA product creates confusion in the exact area that we and others have labored over the years to address: MCAs are not loans, and they do not carry interest – therefore, there fundamentally can be no APR for an MCA product.

III. CONCLUSION

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Thank you once again for considering our comments. We recognize we are a new voice to this discussion, but we would like to express to you our commitment to working with you to implement regulations that provide value to small businesses in general, and local restaurants in our particular case. We would be happy to discuss these matters in person or by telephone. You may reach me at [redacted].

Very truly yours,

DocuSigned by:
[redacted]

Robert Kauffman
Interim General Counsel