STATE FINANCIAL
CORPORATION

SINCE 1967

October 23, 2020

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Department of Business Oversite
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Re: Regulations re SB 1235

Dear Commissioner,

State Financial Corporation and Camel Financial, Inc. are responding to the request for public comment on the impact of the proposed regulations to implement SB 1235. State Financial and Camel Financial are asset based lenders, thus the bulk of our comments will relate to the disclosure of asset based loans.

In State Financial's comment dated January 17, 2019, State Financial described the structure and mechanics of asset based loans. While the revised set of regulations better reflect the structure of asset based loans, the regulations fail in several important respects.

First, asset based loans are most commonly structured as lines of credit subject to a contract with a fixed term. Borrowers access the line throughout the term as needed and replay through collection of accounts receivable. There is nearly always a balance owing. The amount owing is a function of the value of the collateral and the borrower's requests.

The regulations ignore this structure by basing calculations on the assumption that the lender makes only one advance and the transaction ends with the repayment of the first advance not the length of the contract with the borrower—normally a year or longer. During the term of the loan, asset based loans are repaid from payment of the accounts receivable underlying the loan. Commonly accounts carry 30 day terms and are paid in 45 days.

This one advance model has the effect of inflating the APR of asset based loans. All upfront costs are to be treated as if amortized in 45 days, while in reality they are amortized over the life of the contract. For example, a 1% loan fee in for an asset based loan under a one year contract, would add 1% to the APR. But under the regulations this 1% must be added to the cost incurred over the term defined to be the time it takes to pay back any advance(§2057(a)(25)(C)). Not 1 year but 45 days. That one percent becomes 8% annualized.

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Because the regulations fail to match the structure of asset based loans they do not provide an adequate framework for comparing the cost of asset based loans to MCA loans (defined in the regulations as Sales Based Loans). Sales Based Loans normally require payment in a term far greater than 45 days. Thus, all other things being equal an asset based loan under a one year contract becomes 7% more expensive than a sales based loan with a one year term.

For asset based loans with a contractual term of less than one year, the calculations should be based on the contractual term. For an asset based loan with a contractual term on a year or greater the calculation should be based on a one year term.

Second, the regulation prescribing the amount of funds to be used in calculating the APR is confusing and perhaps irrelevant.

The amount of funds is required to be ½ of the line of credit (§2067(a)(2) and §2067(a)(2) referring to §3021). The regulation recognizes than often the first advance under an asset based loan is used to pay off a senior lender (§2067(a)(3)(B)). The problem here is that the amount required to pay off a senior lender is often greater than ½ the contractual line of credit. This leads to the anomalous situation where the disclosed "Funding you will Receive" -- 1/2 the line will be less than the amount required to pay off a senior lender.

For example, assume a $500,000 line, $300,000 in secured debt to be paid off leaving the borrower with $200,000 in working capital. The disclosure requires that the "funding you will receive" be $250,000 where it is obvious to all that the funding would be no less than $300,000.

Here we suggest basing the disclosures on 100% of the line amount.

Following are less substantial instances in which the regulations do not track the financing pattern of the industry

§ 2057(a) (2) very often the financier is not obligated to make advances, advances are discretionary. We suggest simply striking the words "that a financer is required to pay a recipient."

§ 2057(a) (4) most often the assumptions necessary to make the disclosure are not available at the time the first quote is made. For example, the time it takes for a borrower's customers to pay the invoices is not known until the financer audits. We suggest the DBO consider the section be changed to require disclosure 24 hours before funding.

Generally:

§ 2057(b) states that "all references to average" refer to "mean." We don't follow. We suggest using a word search and using "mean" in the regulations where you mean "mean," and average where you mean average.

§2060(a)(5) requires the APR to be expressed to the nearest 10 basis points §3001(b) provides a safe harbor of the APR calculation is accurate to within 1/8th of 1% . We suggest that regulations use basis points or fractions, but not both.

Thank you.

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[redacted]	
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