

October 28, 2020

The Honorable Manuel P. Alvarez
Commissioner, Department of Financial Protection and Innovation
1515 K Street, Suite 200
Sacramento, CA 95814-4052

Subject: Proposed Text of Rulemaking on Commercial Lending Disclosures

On behalf of the Electronic Transactions Association (“ETA”), we appreciate the opportunity to share our thoughts regarding the Proposed Text of Rulemaking on Commercial Lending Disclosures. ETA is encouraged by the positive response of the California Department of Financial Protection and Innovation (DFPI) to stakeholder feedback, and we appreciate the opportunity to submit further comment. ETA supports transparency in small business financing disclosures, including providing borrowers with the best information to compare costs and make informed decisions. The competitive marketplace for small business lending dictates that transparency be front of mind for all parties in the relationship. Unfortunately, we are concerned that, in its current state, the proposed rulemaking will not achieve those objectives and instead will create confusion and uncertainty for California’s small business customers trying to make informed decisions about the cost of financing products. ETA believes that cost comparison and customer choice are best preserved by the competitive marketplace.

ETA is the leading trade association for the payments industry, representing over 500 companies that offer electronic transaction processing products and services, including financial institutions, transaction processors, payments networks, and others. ETA also has members that are engaged in online lending for commercial enterprises, primarily small businesses, either directly or in partnership with other lenders.

General Comments

Here are commercial loan disclosure principles that we believe could provide small business finance companies a uniform set of principles to guide transparency and disclosure.

(a) Any entity making a commercial loan shall provide to the borrower a written statement showing in clear and conspicuous terms all of the following, as applicable, with respect to that commercial loan:

(1) Commercial Loan Costs.

(A) For a commercial loan not under an open-end credit program, as defined in Section 2057, commercial loan costs shall include, as applicable, the total dollar

costs to be charged to a borrower, assuming the borrower pays the commercial loan according to its original payment schedule, plus all required fees and charges that cannot be avoided by the borrower.

(B) For a commercial loan under an open-end credit program, as defined in Section 2057, commercial loan costs shall include, as applicable, the total interest to be charged to a borrower, based on the amount scheduled to be drawn by borrower at the time of disclosure, or if no initial draw is scheduled then the maximum draw amount of credit available under the open-end credit program, in each case assuming the borrower repays the commercial loan according to its original payment schedule, plus all required periodic and non-periodic fees and charges that cannot be avoided by a borrower.

(2) Commercial Loan Amount.

(A) For a commercial loan not under an open-end credit program, as defined in Section 2057, the principal loan amount of the commercial loan and, if different from the principal loan amount, the total amount disbursed to the borrower or at the borrower's direction, as applicable, after deducting any fees and charges that will be withheld from loan proceeds.

(B) For a commercial loan under an open-end credit program, as defined in Section 2057, the maximum amount of credit available for draw by the borrower under the open-end credit program and, if applicable, the amount scheduled to be drawn by the borrower at the time of disclosure.

(3) A description of the terms of repayment, including for a commercial loan not under an open-end credit program, the amount, number and frequency of any scheduled payments, as applicable.

(4) If applicable, the fact that a licensee has acquired or will acquire a security interest in collateral and a description of the collateral.

(5) A description of any other fees in connection with the commercial loan that can be avoided by a borrower, including late payment fees and returned payment fees.

(b) The statement required by this section shall be provided to the borrower prior to execution of the commercial loan agreement, either as a separate disclosure or as part of the commercial loan agreement.

Specific Recommendations

In addition to the principles above, here are some more specific recommendations based on the proposed rulemaking.

APR Disclosure

2060(a)(5) – We believe that this section and others requiring expression of cost in the form of an APR calculation should be deleted. If an APR disclosure was required for commercial loans, such a disclosure has the potential to be even more confusing and less useful for small businesses for many reasons, including the following:

- a. Mandating the calculation of APR under TILA in a commercial setting would result in different calculations depending on the product, even if the overall repayment amount is the same. For example, TILA does not contemplate daily pay loans. How would weekend and bank holidays be addressed? Some lenders skip those days and others require make up payments. If lenders address these issues differently, it will result in different APRs for the exact same product, even when the total dollar cost of credit is the same. There is no benefit to a small business by imposing an APR disclosure on a product that was never contemplated to be covered by TILA and that would result in misleading APRs.
- b. APR calculations are highly duration-sensitive for loan terms of less than a year. In other words, the APR increases rapidly the shorter the loan term. For example, the APR of typical short-term commercial loans will fluctuate widely based on only small differences in the term of the loans.
- c. TCC is more useful for comparing the absolute cost of a loan with a small business's expected return from investing the loan proceeds. A business that expects a short-term return on its investment would likely choose a loan with a shorter term and higher monthly payments to minimize TCC, even though that loan is likely to have a higher APR.
- d. Similarly, certain commercial finance products, such as Merchant Cash Advances (“MCAs”), have a fixed cost but no fixed term and are paid through a set percentage of the small business' future receivables or sales. Solely focusing on the effective APR of such transactions would not tell the whole story because, if the business has higher sales than expected and delivers the purchased receivables faster than anticipated, the duration of the transaction decreases and the effective APR increases.

The clearest cost disclosure is the dollar cost of credit or total cost of capital, which is what matters to small business owners, and what the industry should be providing across all products. Total cost is readily calculable and provides the clearest basis for comparison among commercial finance options, no matter how they are denominated (loan, MCA, factoring, equipment lease).

Safe Harbors

- For some types of financing products, the proposed regulations may require financiers to provide an intricate set of assumptions to generate estimates. This may result in disclosure that is more complicated and difficult to understand than disclosure that explains pricing in plain English. Final regulations should provide that calculations based on specified assumptions shall not be used as the basis for any civil claim as long as the assumptions are disclosed in the manner required by the regulations.

Estimating APR

- The final regulations should encourage the use of the underwriting method.
 - Disclosure of how long a financier actually expects a business to pay back a financing product is more helpful to a borrower than an estimate based on a historical projection that has little connection to what the actual expected annualized cost of the financing will be. Mandatory use of the historical method could result in difficult-to-understand scenarios in which the estimated term is longer than a loan's maximum term.
 - Regulation Z simply requires financiers to use the best available information when generating estimates. Retrospective analyses of the accuracy of estimates, and restrictions tied to the inaccuracy of estimates, is completely novel. It is unnecessarily burdensome to introduce such narrow accuracy margins for audited APR spreads without any analysis of how these margins were arrived at or how they are expected to benefit the small business financing market in California
 - Sales-based financing products are designed to provide flexibility to borrowers. Scenarios where the effective APR ends up being more or less than the estimated APR are expected outcomes, and a core element of the product.
 - We also recommend the accuracy margins be much larger, and there should be no penalty for estimating an APR in excess of effective APR. In other words, the penalty should not apply to negative audited APR spreads.
- The final regulations should clarify that finance charge and APR disclosures for open-end credit may be provided in accordance with Regulation Z's provision for prospective disclosures for open-end credit under 12 C.F.R. part 1026.6.
 - A "finance charge" is defined to include all charges that would be included in the finance charge as under 12 C.F.R. part 1026.4 (Regulation Z).
 - This general definition can be a poor fit for open-end credit where certain kinds of fees included in a finance charge cannot be known in advance TILA and Regulation Z recognize this by specifying what must be disclosed at the time of an account opening (12 C.F.R. part 1026.6). Specific fees, e.g., transaction fees, that are finance charges must be described, but it is not possible to know in advance what

those fees will amount to during a given period so as to include them into a prospective APR.

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We appreciate you taking the time to consider these important issues. If you have any questions or wish to discuss any aspect of our comments, please contact me or ETA Senior Vice President, Scott Talbott at Stalbott@electran.org.

Respectfully Submitted,



Tom Bloodworth
State Government Affairs
Electronic Transactions Association
TBloodworth@electran.org
(731) 414-3415