

**Comments Regarding Modifications to Proposed Regulations  
Under Division 9.5 of the California Financial Code  
Commercial Financing Disclosures (PRO 01-18)**

The Revenue Based Finance Coalition (“RBFC”)<sup>1</sup> is comprised of responsible finance companies that provide needed capital to small businesses through innovative methods. RBFC members offer accounts receivable purchase financing to small businesses and some members also engage in lending in the state of California through a California Financing Law license. Our members also include select vendors that provide technology services to the small business finance industry. This letter responds to the Department of Financial Protection and Innovation’s “Notice of Second Modification to Proposed Regulations Under Division 9.5 of the California Financial Code” dated August 9, 2021.

We respectfully submit the following comments:

**1. Substantive Changes to the Definition of “Broker”**

In Section 2057(6), the definition of “broker” has been revised as follows:

~~(6) “Broker” means any person other than a financier who communicates a financing payment amount, rate or price relating to a commercial financing to a recipient based upon information from, or about, the recipient.~~

(6) “Broker” means any person other than a financier or recipient who does any of the following: participates in any financing negotiation; counsels or advises the recipient about financing options; participates in the preparation of any financing documents, including financing applications; contacts the financier on behalf of the recipient other than to refer the recipient; gathers financing application documentation or delivers the documentation to the financier; communicates financing decisions or inquiries from the financier to the recipient; or obtains the recipient’s signature on financing documents.

This new definition of the term “broker” is significantly overinclusive. For example:

- a licensed attorney who “participates in the preparation of” a financing provider’s financing documents but does not engage in any negotiations or even communication with a financing recipient could be considered a “broker”;
- an employee of a financing provider who “communicates financing decisions or inquiries from the financier to the recipient” could be considered a broker;
- an accountant who “gathers financing application documentation or delivers the documentation to the financier” could be considered a broker;
- a notary public or electronic signature service that “obtains the recipient’s signature on financing documents” could be considered a broker.

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<sup>1</sup> The RBCF is formerly known as the Commercial Finance Coalition.

We respectfully request that the DFPI address why it has made a significant substantive change to its disclosure regulations. Based on our review of the public comments submitted to the DFPI, no member of the public suggested such a change. In addition, this new definition of broker does not appear elsewhere in California law and we are not aware of any other state or federal statute or regulation using this definition for a broker in either consumer or commercial finance.

We also respectfully request that the DFPI revise this new definition of broker to:

- exclude an employee of a financing provider;
- exclude a licensed attorney who has no direct contact with the recipient, other than after the financing acquisition process has been completed;
- remove the phrase “gathers financing application documentation or delivers the documentation to the financier”;
- remove the phrase “or obtains the recipient’s signature on financing documents”;
- remove the phrase “communicates financing decisions or inquiries from the financier to the recipient”; and
- include only a person who receives separate, identifiable compensation for providing brokering services.

## **2. Changes to the Definition of “Amount Financed”**

In Section 2057(30)(A) through Section 2057(30)(F), the definition of “Amount Financed” has been revised to deduct “any prepaid finance charge.” This revision creates a substantive conflict regarding disclosure of “funds paid to brokers” and the “Amount Financed” in a sales-based financing transaction.

Under Regulation Z’s definition of “finance charge” (incorporated in the proposed regulations by reference in Section 3010), a third-party broker fee is a “finance charge” if the financing provider requires the use of the broker or retains any portion of the broker fee. 12 C.F.R. 1026.4(a)(1). Regulation Z further provides that if the financing provider deducts a finance charge (including a third-party broker fee) from the funds advanced to the recipient (i.e., withholds the finance charge from the proceeds), then the amount so deducted is a “prepaid finance charge”. 12 C.F.R. 1026.4(a)(23).

Under the DFPI’s revised definition of Amount Financed, “any prepaid finance” charge is deducted from the amount of funds provided/the advance, resulting in an Amount Financed that does not include prepaid finance charges. Accordingly, a fee paid to a third-party broker that is a “prepaid finance charge” will be deducted from the advance to get an “Amount Financed.” (Notably, the model forms of the Itemization of Amount Financed in Section 3027 assume this scenario – that is, that the broker fee is a finance charge that is deducted from the advance/proceeds to get the amount financed. Both model forms of disclosure treat the broker fee as a prepaid finance charge).

However, the DFPI’s definition of “funds paid to brokers” is “the total amount of *the amount financed* that will be paid to any broker.” Section 2057(32) (emphasis added). As a result, the revised definition of Amount Financed creates a situation where a third-party broker fee might be excluded from the Amount Financed as a prepaid finance charge, but not included in “funds paid to brokers” as defined in Section 2057(32) because it is excluded from the Amount Financed.

The model itemizations of Amount Financed in Section 3027 highlight this problem. These itemizations exclude brokerage fees as prepaid finance charges, which would mean that the fees provided in the examples are not “funds paid to brokers” as defined by Section 2057(32). This definitional issue not only creates confusion, but also creates a host of other problems because the required disclosures for sales-based financing in Section 2065(a)(2)(c) vary based on whether the Amount Financed includes “funds paid to brokers”. Under the proposal, in the case where a broker fee is a prepaid finance charge (and thus, not “funds paid to brokers”) it is not clear which of the alternative disclosures in Section 2065(a)(2)(c) applies.

We respectfully request that the DFPI revise the regulations to fix this definitional issue that creates substantive problems with the disclosure requirements.

### **3. Effective Date of Regulations**

In the DFPI’s Initial Statement of Reasons released on September 2020 (<https://dfpi.ca.gov/wp-content/uploads/sites/337/2020/09/Initial-Statement-of-Reasons-SB-1235-9.2.pdf>), the DFPI stated that it would delay the effective date as follows:

#### Effective Date of the Regulations

The Department anticipates that the proposed regulations will go into effect, if adopted on or before January 1, 2021, on July 1, 2021. Since the proposed regulations will require affected businesses to implement new practices and procedures, July 1, 2021 represents a 6-month delay from the anticipated date of adoption in order to come into compliance. If, however, the proposed regulations are adopted after January 1, 2021, the effective date will adjust accordingly to maintain a 6-month delay in effectiveness. effectiveness of the regulations for at least 6 months.

However, in the most recent Notice of Modifications to Proposed Regulations, the DFPI made the following statement:

Please note that the proposed modifications are not yet effective and will not be effective until approved by the Office of Administrative Law and filed with the Secretary of State in accordance with Government Code section 11349.3.

If the proposed regulations go into effect accordance with Government Code section 11349.3, the effective date could be fewer than 6 months from adoption. We respectfully request that the DFPI honor the initial statement that effectiveness would be delayed at least 6 months.

Finally, we respectfully note that although we have a limited number of comments, we have many additional substantive concerns regarding the accuracy and effectiveness of the proposed regulations. We have limited our comments to addressing the most recent substantive changes to the proposed regulations in keeping with the Cal. Gov. Code § 11346.8. We would welcome the opportunity to further engage with the DFPI on the proposed disclosure regulations.