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August 24, 2021

Via E-Mail: [redacted]@dfpi.ca.gov
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Commissioner of Financial Protection and Innovation
Attn: Sandra Sandoval, Regulations Coordinator
300 South Spring Street, 15th Floor
Los Angeles, CA 90013

Re: Comments on Proposed Regulations for implementation of Commercial Financing Disclosure Regulations

Dear Commissioner:

The Secured Finance Network (formerly known as the Commercial Finance Association) ("SFNet") is the international trade organization founded in 1944 representing the asset-based lending, factoring, trade and supply chain finance industries, with 270 member organizations throughout the State of California, the U.S., Canada and around the world. As we have outlined in our conversations with your staff and prior comment letters, we continue to have concerns regarding the disclosure requirements under Commercial Finance Disclosures enacted under SB1235 (Chapter 1011, Statutes of 2018) and signed into law by Governor Brown on September 30, 2018 ("Disclosure Requirements") as well as the regulations proposed by the California Department of Financial Protection and Innovation regarding compliance with the Disclosure Requirements ("Proposed Regulations"). SFNet and its members strongly urge you to take the below comments and suggestions into account with respect to the Proposed Regulations.

DISCLOSURES FOR FINANCING CHANGES

Under the latest draft of the Proposed Regulations, Section 2057(a)(4)(C) provides that disclosure will be required subsequent to the consummation of the commercial financing contract if the contract is "amended, supplemented or changed" and the resulting change would result in an increase in the finance charge. As we have discussed previously with the

DFPI, factoring and asset-based credit facilities are designed to provide working capital for the recipient and therefore have to adapt to the working capital needs and fluctuations of the recipient. Because of the need to have the ability to adapt, "changes" to these financing arrangements may occur often during the term of the financing. Requiring the factors and asset-based lenders to re-disclose the information as required by the Disclosure Requirements can be burdensome to the financing provider and create confusion for, and provide no value to, the recipient.

(1) Under this situation, the recipient may not be looking to multiple sources of financing to compare the best product available to them and a re-disclosure does not provide any useful information for the borrower to compare against other financings.

(2) The accommodation can be a temporary increase in the advance rate or to the total credit available for a short period of time to satisfy the immediate liquidity requirement. It is not uncommon for this accommodation to last less than 90 days. How is the provider to re-disclose based on this short-term accommodation? Is the accommodation to be treated as a separate financing arrangement or will all assumptions need to be redone as if the disclosure is being provided on the inception of the credit facility? On top of creating a burden at a time when the recipient needs a nimble lender, it is almost certain that this re-disclosure will provide information which will not be useful for the recipient.

We propose a few ways in which the re-disclosure requirement may be tailored to provide more useful information to the recipient while staying in line with the public policy.

(1) Excluded Avoidable Fees and Expenses. In many instances when changes are made to a financing, they are due to a request by the recipient. In the above, example, it is the recipient who is asking for an accommodation to the credit facility to obtain additional liquidity necessary to fulfil a customer order. We request that an exception be included in the regulations for re-disclosure due to increases in the financing charge due to the charging of avoidable fees that were charged due to a modification, supplement or change made at the request of the recipient.

(2) Exclusion for Ordinary Course Changes. As discussed above, all businesses, small and large will have ebbs and flows and a financing provided to such business will have to adapt to these changes. There will be ordinary course modifications to a factoring facility or asset-based facility which should not trigger a re-disclosure as these changes could happen often and create a burden on the financier and confuse small business at a time when the small business is not looking for new financing or the ability to compare one financing product against another financing product. We request an exclusion for re-disclosure related to changes in the financing if the changes are in the ordinary course of business.

(3) Changes in Writing. Generally, accommodations made to the recipient during a life of a financing are documented in writing when they are material changes to the financing. Limiting the re-disclosure requirement to written changes to the

financing documents would make the re-disclosure requirement more meaningful to the recipient as it would capture material changes to the financing.

TYPES OF ASSETS SUPPORTING A FACTORING OR ASSET BASED FACILITY

The definition of “Approved Credit Limit” set forth in Section 2057(a)(2) of the Proposed Regulations appears to make a distinction between the different types of collateral supporting a financing. In practice, financings may also be made based on the value of a recipient’s accounts receivable, inventory or other property.

Example: A provider may provide a loan which will be limited to the value of the recipients inventory up to $300,000 plus the value of the recipients accounts receivable up to $600,000. Although these are part of a single commercial financing being provided by one provider to a recipient, documented on one set of documents and subject to the same fees and interest rate, under the current draft of the Proposed Regulations, the advances based on the value of inventory will require a disclosure while the advances based on the value of accounts receivable will not.

This separate treatment simply because each category of collateral has its own advance limit will create a great deal of confusion for recipients as the disclosure will only provide part of the picture. As such, we request that the aggregate credit limit be used to determine the Approved Credit Limit and not the limit placed on each class of collateral.

We direct you to our proposed language changes set forth in our comment letter of April 23, 2021.

NON-BORROWING/COLLECTION FACTORING FACILITIES.

From time to time, factors enter into transactions pursuant to which they provide back office accounts receivable support for recipients. These transactions are referred to as “non-borrowing factoring” or “collection factoring.” The factor does not provide an advance to the recipient, provide any credit to the recipient or purchase accounts receivable from the recipient. These transactions are generally entered into with small business that do not have the back-office personnel necessary to manage the recipient’s accounts receivable and pursue collection from customers. All of which is handled by the factor. These transactions essentially provide a service by the factor to the recipient for a fee and are not a commercial financing.

Although the Disclosure Requirements do not specifically include this type of transaction, they do not specifically exclude them either. However, since the Disclosure Requirements only apply to commercial financing transactions, by definition, these transactions should be exempt from the Disclosure Requirements.

The failure to address such non-borrowing/collection factoring transactions in the Proposed Regulations has created a great deal of confusion for our members and we request that language be inserted into the regulations to make it clear that these types of transactions are not subject to the Disclosure Requirements.

AFFILIATED RECIPIENTS

Commercial financings are often provided to related recipients or co-recipients. For example, a recipient that owns two restaurants may create a legal entity for each restaurant. However, when seeking financing, it is common for the two restaurants to be treated as co-borrowers under a commercial financing. The test as to whether the disclosure requirement applies should be at the aggregate joint and several maximum liability for recipients related by common ownership not at the individual recipient. For example, assume the approved advance limit for one recipient is $550K and for a related recipient the approved advance limit is $200K. Under current rules, the first recipient would not need to be provided the disclosure, but the second one would. However, as long as the two related recipients are joint and severally liable on each others' commercial financing, they should be treated as one financing with an approved advance limit equal to the maximum joint and several obligation. Therefore, §2057(a)(20) of the Proposed Regulations should be revised by adding the following at the end of such subparagraph:

> "Recipient" shall mean and be interpreted as to any recipient (considered the "first recipient") to include any other recipient that controls, is controlled by, or is under common control with the first recipient and which obligations under a commercial financing are joint and several."

SAFE HARBOR

Although we appreciate the Proposed Regulations allowing for a tolerance in Section 3026, because of the numerous assumptions required to allow factors and asset-based lenders to provide an APR calculation, even the best estimation and assumptions could result in a margin of error greater than the tolerance level provided. Therefore, we continue to strongly urge the DFPI to provide a safe harbor for providers of commercial loans to small business which insulates the providers from liability (through litigation or otherwise) if they comply with the Disclosure Requirements in good faith. This would be very similar to safe harbors contained in the Federal Truth-In-Lending Act for consumer lending disclosures. Specifically see 15 U.S.C. § 1640(b) and 15 U.S.C. § 1640(c). The safe harbor is necessary because many of the providers of commercial loans to small businesses are small businesses themselves and can't absorb the cost of litigating perceived violations of the Disclosure Requirements when they are acting in good faith to comply.

Sincerely,

Richard Gumbrecht
Chief Executive Officer
Secured Finance Network

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