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August 23, 2021

Commissioner of Financial Protection and Innovation
Attn: Sandra Sandoval
Regulations Coordinator
300 South Spring Street
15th Floor
Los Angeles, CA 90013
By email: regulations@dfpi.ca.gov

Re: California Code of Regulations
Title 10, chapter 3
2nd Modification

Dear Ms. Sandoval,

Following are my comments to the 2nd Modification to Title 10 Chapter 3 of the California Code of Regulations. My comments are limited to Asset Based Lending Transactions.

First some housekeeping issues:

1. Section 2057. The defined terms are no longer in alphabetical order. See for example §2057(a)(29) et seq. Please promote ease of navigation and re alphabetize this section.
2. Section 3021. The reference to §2062 should be to §2067.
3. Section 3026(a)(3). The reference to §3000 is no longer applicable. Section 3000 has been deleted.

More substantively:

4. Section 2057(4). Note this section will generally require two disclosures. First, when a proposal is made; at this time any proposal will be based on the Borrower's estimates. Second, following an audit when those estimates are confirmed and likely adjusted.

5. Section 2067(3).

Specifically:

Section 2067(a)(3)(A). “Funding Provided” is not defined (its definition has been deleted) its calculation is not explained. Nor is the term tied to language in §3027.

Section 2067(a)(3)(B). “Amount Financed” is defined in §2057(a)(30) with reference to with reference to §3021(a)(2)(A) or (a)(3)(A); §3021 uses the term “shall.” Thus I conclude that §3021 is not an alternative at all - the approved credit limit is the amount that must be disclosed as the Amount Financed instead of estimates based on the status of the Borrower’s business at the time disclosures are made. This is important, see the following paragraph. My interpretation may be wrong, but it is reasonable. If wrong you must clean up the language, if correct, just say so in in §2067(3)(B) -- "the amount financed is the Approved Credit limit as defined in Section 3021.”

You must understand the significance of making the §3021 amount the Amount Financed for the calculation of Estimated Finance Charge in Section 2067(a)(5). First keep in mind, asset-based loan agreements universally provide an approved credit limit in excess of current borrowing needs. Then, assume a \$275,000 approved line of credit provided to a borrower who has \$250,000 in eligible accounts receivable with \$200,000 available to borrow on initiation (no matter whether some is disbursed to pay off debt to third parties or all is disbursed to the borrower.) Assume further collections on those accounts historically average \$175,000 per month. Finally, assume, as is universally the case, the lender charges interest on the loan balance and “float” on collections (a charge of the volume of collections on accounts receivable).

If the §3021 alternative wasn’t an alternative and a lender disclosed based on estimates of the Borrower’s current financial status, the lender would calculate charges based on \$200,000 in borrowing (or what the borrower claims it needs, perhaps only \$150,000) and historical monthly collections--\$175,000.

Requiring a §3021 disclosure, the Amount Financed disclosure will be on a loan balance for which the borrower does not qualify. This at least is easy to calculate. However, is the float calculation to be based amounts which do not support an approved credit limit of \$275,000 -- collateral of \$250,000 and reported monthly collections of \$175,000? Or is the float calculation to be based on hypothetical collateral and collections which would? (Eligible Accounts receivable of at least \$343,000 and imaginary collections of that amount.) Neither is realistic.

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Section 2067(a)(4). The difference between “Estimated Annual Percentage Rate” (subsection (A)) and “annual percentage rate calculated in accordance with Section 3001” (Subsection (B)) is not apparent.

Section 2067 (5). Similarly, the difference between "Estimated Finance Charge and the “Finance charge calculated pursuant to Section 3010, also is not apparent.

6. Section 3027. The terms in §2067(a)(3)(c)(ii)(iii) do not tie to the terms in §3027. For instance, “Amount Given Directly to You” appears to be “Recipient Funds” but, for both borrowers and lenders it would be helpful if the tie was made explicit. Using different names for the same concept invites confusion. What is to be included in the itemization of “Amount Paid on Your Account with Us” is not clear. If it is meant to include Prepaid Finance Charges (commonly charged by asset-based lenders, it would be helpful if the tie was added in brackets [for example: prepaid finance charges].

Generally:

I attempted to complete the §2067 matrix for an ordinary standard State Financial loan. I can assure you that State Financial cost structure is as simple as any of our competitors.

Navigating the section reveals the need to make numerous assumptions regarding the borrower’s financial status, and the need to make numerous interpretations and assumptions regarding the meaning of the regulations. For instance, simple assumptions such as how many days a month a borrower may borrow and how many electronic payments are received a month will effect the amount bank fees which are charged to a borrower. As difficult it was for me to make the assumptions necessary to complete the matrix, and as arbitrary as some of them were, there is no reason to think two lenders will make the same assumptions the same way.

Moreover, completing the matrix requires interpretations and assumptions regarding the meaning of the regulations. I suggest they be tightened. See for example the earlier discussion of §3021 and regarding the term “Recipient Funds.” Also, by example, §2057(a)(30)(F) excludes a one time loan fee from the definition of “Amount Financed.” How that carries through to §3027 disclosure also is one of interpretation.

Competing interpretations and assumptions undercuts the goal of apples to apples comparison. To make a comparison meaningful, the regulations should be tightened to underscore the existence of financial assumptions, the effect of different assumptions presented by one or mores and tightened also to provide brighter lines and reduce the need for interpretation.

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Finally, I trust that one of the DFPI's goals is to make it as easy for a lender to comply with these regulations as it is to make it easy for a Borrower to understand the §2067 matrix. The goal is mutually reinforcing. The simpler it is for a lender to comply the clearer will be the result.

Sincerely,

State Financial Corporation



Gary Reiss
President

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