



August 24, 2021

[Via email to regulations@dfpi.ca.gov](mailto:regulations@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: Notice of Second Modifications to Proposed Regulations Under Division 9.5 of the California Financial Code (Pro 01/18)

Dear Department of Financial Protection and Innovation:

Stripe appreciates the opportunity to provide input on the Department of Financial Protection and Innovation's (DFPI) notice of second modifications to proposed regulations (the **Proposed Regulations**) under Division 9.5 of the California Financial Code. Stripe supports measures to help recipients better understand the terms of their commercial financing arrangements and effectively comparison shop between products. We thank the DFPI for its extensive efforts to implement Sections 22800–22805 of the California Financial Code and give providers of commercial financing products certainty with respect to the content, timing, and format of required disclosures.

We are writing this letter to: (1) reiterate our concerns that the Proposed Regulations' approach to open-end credit products will generate borrower confusion; (2) provide the DFPI additional information to evaluate those concerns; and (3) urge the DFPI to consider adopting the disclosure approach set out in Regulation Z.¹ The Proposed Regulations' rules require providers to combine rates and fees to calculate the annual percentage rate (APR) for open-end credit products.² As previously raised in comment letters to the DFPI, the result is a hybrid figure that presents inherent challenges to clear and meaningful disclosure of the cost of credit.³ This is especially true where an open-end product, such as a charge card, does not charge interest.

The Board of Governors of the Federal Reserve System (the **Federal Reserve**) attempted a similar mixed disclosure approach in historical versions of Regulation Z, but eliminated those requirements after finding, through years of research, that the resulting disclosures were largely unintelligible to consumers. We believe that today's Regulation Z, provides an effective model for ensuring comprehensive as well as clear disclosures of rates and fees, and encourage the DFPI to apply this model to the Proposed Regulations.

¹ 12 C.F.R. Part 1026—Truth in Lending (**Regulation Z**).

² Rates are interest rates applied to periodic balances. Fees are transaction-based and other fees, the sum of which may depend on how a borrower uses a product.

³ Stripe previously raised this issue in our letter to the DFPI, dated October 28, 2020, on the initial text of the Proposed Regulations dated September 11, 2020. The Electronic Transactions Association, of which Stripe is a member, also raised this issue in its letter to the DFPI, dated April 26, 2021, on the modifications to the text of the Proposed Regulations dated April 7, 2021.



Section I of this letter provides an overview of Stripe and its commercial financing products. Section II expresses our support for clear and conspicuous disclosure of all finance charges. Section III explains why APR is not the right disclosure format for all finance charges; including all finance charges in APR for open-end credit products results in a cost of credit figure that makes it difficult for borrowers to effectively comparison shop. Section IV recommends that the DFPI should follow Regulation Z's approach in its Proposed Regulations and, to that end, proposes revisions to the rule text. Finally, Section V recommends that the DFPI grant itself the flexibility to permit alternative disclosure formats when consistent with the spirit of the California Consumer Financial Protection Law.

I. Overview of Stripe and Our Commercial Financing Products

Stripe is a technology company that builds economic infrastructure for the internet. Businesses of all sizes, from new startups to public companies, use our software to accept payments and manage their businesses online. In addition to our payments infrastructure, we provide businesses access to commercial financing made available through bank partners. For example, Stripe Capital helps our business users access flexible closed-end loans originated by partner banks that they can pay back as they generate revenue rather than on a rigid, fixed payment schedule. Users are only charged a single upfront fixed fee—there are no prepayment fees, late fees, or interest charges. Additionally, Stripe Issuing helps businesses create, manage, and distribute virtual and physical open-end credit cards issued by partner banks. Our application programming interfaces (**APIs**) allow businesses to manage spending and expenses in real-time. Users are charged card creation and transaction-based fees—there are no prepayment fees, late fees, or interest charges.

Stripe designed these products with our users' needs in mind. We developed Stripe Capital because one-third of our users cite access to capital as their biggest inhibitor to growth. We launched Stripe Issuing to provide our users with a seamless way of creating customized commercial card programs. By assessing limited, use-based fees (e.g., transaction fees) instead of interest, users are easily able to forecast their program cost. This predictability enables Stripe users generally, and smaller businesses in particular, to better manage corporate spending.

Transparent and simple disclosures are key to customer satisfaction, and we consider these concepts to be core elements of our product design. To that end, we regularly survey our users to gauge their understanding of and satisfaction with our financing products and improve their experience.

II. Stripe Supports Clear and Conspicuous Disclosure of all Finance Charges

Stripe supports the clear and conspicuous disclosure of all finance charges, and therefore supports the DFPI's cross-reference to 12 C.F.R. Part 1026.4 to incorporate Regulation Z's definition of finance charge into the Proposed Regulations.

One of the objectives of Regulation Z's broad definition of finance charge is to prevent creditors from evading disclosure requirements by hiding the cost of credit in fees that may be less visible to a borrower. Stripe believes that this broad definition of finance charge is appropriate and necessary for borrowers to understand the cost of credit and engage in comparison shopping. Moreover, Stripe believes that this



definition of finance charge is appropriate for the required disclosures of finance charges for open-end credit products.⁴

III. Including All Finance Charges in the APR Calculation for Open-End Credit Products Will Generate Significant Borrower Confusion

The Proposed Regulations require that the APR for open-end credit products include all finance charges, which creates significant challenges for clear and meaningful disclosure of the cost of credit. Specifically, this approach can make products that are similar in total program cost appear to be dramatically more or less expensive than one another simply due to their settlement structures.

Section 2062(4) requires providers to disclose the APR cost of open-end credit products, calculated in accordance with Section 3001.⁵ Section 3001(a) provides that the APR is “a measure of the cost of credit, expressed as a yearly rate, that relates the amount and timing of value received by the recipient to the amount and timing of payments made to the provider” and that “[f]or purposes of this subchapter, the annual percentage rate shall be determined in accordance with either the United States Rule method or the actuarial method, as both are set forth in Appendix J, 12 C.F.R. Part 1026.” Section 3001(d) also provides the APR calculation should “include all finance charges as defined in Section 3010” and that “[w]hen calculating the required disclosures for the commercial open-ended credit plans made pursuant to Section 2062, the provider shall assume that the recipient borrows the approved credit limit at origination and makes no subsequent draws and that minimum on-time payments are made pursuant to the contract.” All finance charges as defined in Section 3010 include all finance charges as defined in 12 C.F.R. Part 1026.4, as described in footnote 5.

Rather than providing clarity, the APR produced by this calculation method may obscure the cost of credit for open-end credit products that exist in the market today. Take, for example, an open-end credit product for which no interest charges are applied to periodic balances, such as a charge card. Users are charged: (a) a card creation fee to generate a card to begin drawing on a credit line; (b) transaction-based fees equal to 0.2% of each transaction plus a 20 cent fixed fee for each transaction; and (c) foreign exchange fees if the transaction involves a currency conversion. The Proposed Regulations would require a provider to assume that the borrower draws the entire approved credit limit at origination, so a provider would be required to sum all finance charges that would be assessed on a single transaction the size of the entire approved credit limit. This approach generates a few complications.

First, the Proposed Regulations do not provide guidance to providers on which finance charges to include in the APR calculation when the fees are contingent on a borrower’s choices. For example, if a provider charges foreign exchange fees, it is not clear whether a provider may assume that the initial draw at

⁴ Specifically, Section 2062(5) of the Proposed Regulations requires financiers to disclose the total finance charge calculated in accordance with Section 3010. Under Section 3010, the “finance charge” is the sum of “all charges that would be included in the finance charge under 12 C.F.R. Part 1026.4 (effective April 1, 2019), if the transaction were a consumer credit transaction and the financier were a creditor under federal law.” 12 C.F.R. Part 1026.4 defines “finance charge” to include a wide variety of charges that may be assessed in connection with a credit transaction, including interest and transaction charges.

⁵ Unless otherwise specified, “Section” refers to a section of the Proposed Regulations.



origination does not involve a currency conversion. Providers may adopt different approaches as a result of this lack of clarity, impairing borrowers' ability to effectively compare the costs of financing products.⁶

Second, the annualization of transaction-based fees can make open-end credit products with shorter settlement cycles appear dramatically more expensive than similarly priced products with longer settlement cycles.⁷ For example, assuming that a borrower has a \$1000 approved credit limit, for a single \$1000 draw, the provider in our example would charge a transaction-based fee of 0.2% of \$1000 plus 20 cents, or \$2.20. Application of Section 3001 to satisfy the requirement of Section 2062(4) would yield APRs (not taking into consideration card creation or foreign exchange fees) that wildly vary depending on how frequently borrowers settle with the issuing bank:

- *Scenario 1—Monthly Settlement:* With monthly settlement, the APR is roughly equal to $(0.0022 / 30) * 365 * 100 = 2.7\%$.
- *Scenario 2—Weekly Settlement:* With weekly settlement, the APR is roughly equal to $(0.0022 / 7) * 365 * 100 = 11.5\%$.
- *Scenario 3—Daily Settlement:* With daily settlement, the APR is roughly equal to $0.0022 / 1) * 365 * 100 = 80.3\%$.⁸

This variation occurs despite the fact that the borrower pays exactly \$2.20 for every \$1000 they draw:

- *Scenario 1—Monthly Settlement:* If the borrower draws \$1000 in a single transaction each month, their total fees on \$1,000 of borrowing would amount to \$2.20, yielding a fee ratio **0.22%**.
- *Scenario 2—Weekly Settlement:* If the borrower draws \$250 in a single transaction each week for 4 weeks, their total fees on \$1000 of borrowing would amount to \$2.20, yielding a fee ratio of **0.22%**.
- *Scenario 3—Daily Settlement:* If the borrower draws \$33.33 in a single transaction each day for 30 days, their total fees on \$1,000 of borrowing would amount to \$2.20, yielding a fee ratio of **0.22%**.

Even though the fee ratio is identical in each scenario, the Proposed Regulations' prescribed method for APR calculation makes the daily settlement structure scenario appear to be dramatically more expensive.

⁶ The Senate Committee of Banking and Financial Institutions (the **Senate Committee**) recognized this problem while drafting Senate Bill No. 1235 (**SB 1235**), the bill that created Division 9.5 of the California Financial Code, noting that for open-end credit products, "there is no way to predict ahead of time how frequently or by how much a small business will draw down its credit line, and thus no way to reasonably estimate an accurate APR prior to consummation." Senate Committee on Banking and Financial Institutions, California Financing Law: commercial financing: disclosures, hearing dated April 18, 2018, at 10 (the **Senate Committee Report**).

⁷ The Senate Committee also recognized this problem while drafting SB 1235. Specifically, the Senate Committee noted that "APR can be helpful in certain circumstances. Because APR was designed to provide an annualized cost of credit, it can be helpful for comparing loans that are all greater than or equal to one year or when comparing loans of similar lengths. However, it can be confusing if one uses it to compare financing of different lengths, when one of those financing products has a term of less than one year." Senate Committee Report, at 10.

⁸ These calculations use the formula $APR = ((\text{fees} / \text{principal}) / n \times 365) \times 100$, where n = days in the loan term. For the purposes of these examples, in which there is a single repayment in full, this formula produces the same results as the United States Rule method or the actuarial method, both as set forth in Appendix J, 12 C.F.R. Part 1026.



The distortion created by this approach will make it difficult for borrowers to accurately compare the cost of different credit products.⁹

IV. The DFPI Should Adopt Regulation Z’s Approach to Enhance Borrower Understanding

Unlike the Proposed Regulations’ approach, Regulation Z treats APR disclosure and transaction-based fee disclosure for open-end credit products separately. We urge the DFPI to adopt Regulation Z’s approach to more clearly delineate finance charges that should be included in APR calculations (e.g., interest rates) from those that can be separately clearly described to borrowers (e.g., transaction-based fees).

A. Regulation Z Separates Disclosure of Rates and Fees for Open-End Credit Products

Under Regulation Z, at account opening, providers must disclose the APR, defined as “[e]ach periodic rate that may be used to compute the finance charge on an outstanding balance . . . expressed as an annual percentage rate.”¹⁰ Separately, providers must disclose “[a]ny non-periodic fee that relates to opening the plan,”¹¹ “[a]ny fixed finance charge and a brief description of the charge,”¹² and “[a]ny transaction charge imposed by the creditor for use of the open-end plan for purchases.”¹³

Model Form G-17(B) illustrates these Regulation Z disclosure requirements. The model form clearly delineates between disclosure of interest-related charges, which includes APR disclosure, and disclosure of other fees, including transaction-based fees, one-time fees, or fees that depend on borrower behavior.¹⁴ Model Form G-17(B) is included for your reference as Exhibit 1.

B. The Federal Reserve Conducted Extensive Consumer Research to Address a Similar Issue in Regulation Z and Concluded that Consumers Do Not Understand an APR that Mixes Rates and Fees

Model Form G-17(B) was introduced into Regulation Z by the Federal Reserve in a 2009 rulemaking amending Regulation Z.¹⁵ Prior to that 2009 rulemaking, Regulation Z required providers to disclose an “effective APR” in periodic statements following account opening. This “effective APR” reflected both the cost of interest and certain other finance charges imposed during the statement period, effectively mixing rates and fees in an APR calculation.

The Federal Reserve conducted extensive consumer testing of this concept¹⁶ and ultimately determined in the 2009 rulemaking that this method for APR calculation and disclosure generated so much consumer confusion that it was at odds with the purpose of Regulation Z. Specifically, the Federal Reserve wrote

⁹ In surveying these issues, the Senate Committee noted that “[i]t is not surprising that, when the Federal Reserve Board undertook a review of open-end (non-mortgage) disclosure rules in 2009, it eliminated effective APR as a measure of the cost of credit, due to consumer confusion.” Senate Committee Report, at 11. We discuss the rulemaking on “effective APR” referenced by the Senate Committee in greater depth in Section IV.B.

¹⁰ 12 C.F.R. Part 1026.6(b)(2)(i).

¹¹ 12 C.F.R. Part 1026.6(b)(2)(ii)(B).

¹² 12 C.F.R. Part 1026.6(b)(2)(iii).

¹³ 12 C.F.R. Part 1026.6(b)(2)(iv).

¹⁴ 12 C.F.R. Part 1026, Appendix G, G-17(B).

¹⁵ See Federal Reserve, Truth in Lending, 74 Fed. Reg. 5244, at 5432 (Jan. 29, 2009).

¹⁶ See 74 Fed. Reg., at 5317-18. The Federal Reserve conducted at least four rounds of qualitative and quantitative testing, once in 2007 and three times in 2008.



that its research demonstrated “that consumers find the current disclosure of an APR that combines rates and fees to be confusing.”¹⁷ As a result, it eliminated the effective APR requirement entirely when it finalized its 2009 amendments. The Federal Reserve explained that although “a majority of participants evidence some understanding of the effective APR, the overall results of the testing show that most consumers do not correctly understand the effective APR.... [I]n all rounds of the testing, **a majority of participants did not offer a correct explanation of the effective APR**. In quantitative testing conducted for the [Federal Reserve] in the fall of 2008, **only 7% of consumers answered a question correctly that was designed to test their understanding of the effective APR**. In addition, **including the effective APR on the statement had an adverse effect on some consumers’ ability to identify the interest rate applicable to the account.**”¹⁸

C. The Proposed Regulations Can be Revised to Enhance Borrower Understanding

Including all finance charges in the resulting APR calculation, including transaction-based fees as well as one-time upfront fees (e.g., card creation fees), has the potential to result in confusing APR disclosures, particularly for open-end credit products that charge no interest. In fact, a prospective effective APR for an open-end credit product that mixes rates and fees—like the one set out in the Proposed Regulations—is likely to be even more confusing than an ex post effective APR— which the Federal Reserve rejected after finding that it limited the ability of borrowers to understand the cost of credit and compare products.

To adopt Regulation Z’s approach, the DFPI should make the following revisions to the Proposed Regulations:

- *Section 3001*: Insert a new phrase following Section 3001(b), so that it reads:

“(b) The annual percentage rate calculation shall include all finance charges as that term is defined in section 3010 of these rules, except that when calculating the required disclosures for commercial open-ended credit plans made pursuant to Section 2062, the provider may include only those finance charges that would be included in the annual percentage rate calculation for open-end (not home-secured) plans under 12 C.F.R. Part 1026.6(b)(2)(i).”
- *Section 2062(5)*: Insert a new subsection (iii) following Section 2062(5)(C)(ii) that reads:

“(iii) If the contract provides for finance charges that are transaction-based fees, one-time fees, or contingent fees, a sentence stating ‘You may be charged finance charges that are not included in your APR,’ followed by a plain language description of each potential fee.”
- *Section 2062(4)*: Insert a new subsection (iv) following Section 2062(4)(C)(iv) that reads:

“(iv) If the contract does not provide for an interest rate, ‘APR is not an interest rate. Your interest rate is 0%.’”

¹⁷ 74 Fed. Reg., at 5252.

¹⁸ *Id* (emphasis added). See also 74 Fed. Reg. 5316 – 5319 for more discussion of the Federal Reserve’s research on this topic.



Following each subsection (i) through (iv), insert:

“You may be assessed finance charges that are transaction-based fees, one-time fees, or contingent fees that are not reflected in your APR. These finance charges are described below in the row labelled ‘Estimated Finance Charge’.”

V. The DFPI Should Also Create a Pathway for Financers to Seek Approval of Alternative Disclosure Formats

From time to time, innovative products may appear that have features not clearly contemplated by the disclosure categories and requirements set forth in Sections 2061–2068. To ensure that it can remain nimble and react to market developments, the DFPI should include in the final regulations a mechanism by which providers can apply to the DFPI to vary the prescribed disclosures, seek exemptive relief, or request approval of alternative disclosure formats. We note that, in giving itself this flexibility, the DFPI would be acting consistently with the intent of the California Consumer Financial Protection Law to “[promote] nondiscriminatory consumer-protective innovation in consumer financial products and services.”¹⁹ Without this flexibility, innovation in commercial financing products may be influenced or even stifled by rigid disclosure requirements that are not fit for novel products or services, and providers may be compelled to offer disclosures that do not help borrowers understand the cost of credit.

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Stripe thanks the DFPI for its efforts throughout this rulemaking process, and appreciates the opportunity to provide our comments. We share with the DFPI the common goal of helping users of our commercial financing products understand their cost of credit and effectively comparison shop between products.

We would be happy to provide you with additional information to evaluate our comments. Please do not hesitate to contact me at nuveen@stripe.com with any questions.

Respectfully submitted,

/s/

Nuveen Dhingra
Regulatory Counsel

Cc:

Charles Carriere
Jesse Mattson

Enclosed:

Exhibit 1—Model Form G17(B) Account-Opening Sample

¹⁹ Cal. Fin. Code Section 90000(b)(4).



Exhibit 1—Model Form G17(B) Account-Opening Sample

G-17(B) Account-Opening Sample

Interest Rates and Interest Charges	
Annual Percentage Rate (APR) for Purchases	8.99% This APR will vary with the market based on the Prime Rate.
APR for Balance Transfers	15.99% This APR will vary with the market based on the Prime Rate.
APR for Cash Advances	21.99% This APR will vary with the market based on the Prime Rate.
Penalty APR and When it Applies	28.99% This APR may be applied to your account if you: <ol style="list-style-type: none">1) Make a late payment;2) Go over your credit limit twice in a six-month period;3) Make a payment that is returned; or4) Do any of the above on another account that you have with us. How Long Will the Penalty APR Apply?: If your APRs are increased for any of these reasons, the Penalty APR will apply until you make six consecutive minimum payments when due.
Paying Interest	Your due date is at least 25 days after the close of each billing cycle. We will not charge you any interest on purchases if you pay your entire balance by the due date each month. We will begin charging interest on cash advances and balance transfers on the transaction date.
Minimum Interest Charge	If you are charged interest, the charge will be no less than \$1.50.
For Credit Card Tips from the Consumer Financial Protection Bureau	To learn more about factors to consider when applying for or using a credit card, visit the website of the Consumer Financial Protection Bureau at http://www.consumerfinance.gov/learnmore

Fees	
Annual Fee	None
Transaction Fees <ul style="list-style-type: none">• Balance Transfer• Cash Advance• Foreign Transaction	Either \$5 or 3% of the amount of each transfer, whichever is greater (maximum fee: \$100). Either \$5 or 3% of the amount of each cash advance, whichever is greater. 2% of each transaction in U.S. dollars.
Penalty Fees <ul style="list-style-type: none">• Late Payment• Over-the-Credit Limit• Returned Payment	Up to \$35 . Up to \$35 . Up to \$35 .
Other Fees <ul style="list-style-type: none">• Required Account Protector Plan	\$0.79 per \$100 of balance at the end of each statement period. See back for details.

How We Will Calculate Your Balance: We use a method called "average daily balance (including new purchases)." See your account agreement for more details.

Billing Rights: Information on your rights to dispute transactions and how to exercise those rights is provided in your account agreement.