Submitted by Electronic mail to: regulations@dfpi.ca.gov, with a copy to: [redacted]@dfpi.ca.gov

September 16, 2021

Department of Financial Protection and Innovation
Attn: Sandra Sandoval, Legal Division
300 South Spring Street, Suite 15513
Los Angeles, CA 90013

Re: File No.: PRO 02-21 – Second Invitation for Comments on Proposed Rulemaking for California Consumer Protection Law ("Invitation")

To Whom It May Concern,

Small Business Financial Solutions, LLC dba RapidAdvance ("RapidAdvance") would like to thank the California Department of Financial Protection and Innovation ("DFPI") for reaching out for input on the above proposed regulations ("Regulations"). While the proposed Regulations attempt to regulate unfair, deceptive, and abusive acts and practices ("UDAAP"), the Regulations are unclear, not well defined, vague, and cause numerous substantive problems. Below are our comments.

I. OUR COMPANY

RapidAdvance provides working capital to small businesses throughout the United States and operates as a licensed Finance Lender and Broker in California ("CFL License"). RapidAdvance and its affiliates have been providing funding to small businesses for more than a decade and the majority of our customers have grown to become thriving businesses. Our financing products include merchant cash advances ("MCAs") and business loans. MCAs allow small retail businesses to sell their future card sales in exchange for immediate working capital (the transaction is a purchase and sale rather than a loan). The receivables we purchase are delivered to us whenever the merchant batches out its credit card terminal and forwards to us the percentage of funds that we purchased. We do not offer an MCA product in California that includes a true-up mechanism

or a fixed payment amount (each payment truly varies based on the split rate). Our small business loan is similar to a traditional commercial loan with two primary differences. First, the borrower makes daily or weekly payments rather than monthly payments. Second, our loans charge a fixed fee rather than an interest rate. A fixed fee allows our customers to easily determine the actual dollar amount the loan will cost and the more frequent payment schedule ensures the business is not overwhelmed by large monthly payments for years. Our underwriting model allows us to fund businesses that traditional lenders turn away and permits us to offer financing solutions to businesses whose growth is constrained by their ability to access capital. Our customers that qualify for both the loan product and the MCA can choose the product that best fits their needs.

The customers that use our financing products include almost every type of small and medium sized business in California. A customer's annual revenue generally ranges from $250,000 to $4,000,000 and the average funding we provide is about $50,000. Approximately 90% of our customers are limited liability companies or corporations. The online small business finance industry now originates more than $15 billion annually and the overwhelming majority of small businesses that have obtained financing from industry participants prefer our products and process over traditional financing sources. The industry has proven to be a great option for small businesses during COVID. Given our products don't have an accruing rate and many businesses have been shut down or negatively impacted since March of 2020, many of our customers are not in default despite not making payments (MCAs don't require a payment if there is no revenue being generated due to COVID) or have extended their terms under our loan program for free as we do not charge an accruing rate. The current environment is a great example of why our products work better than traditional loan products and why our customers love us.

II. OVERARCHING COMMENTS

As we do not offer commercial financing to non-profits, our comments are solely focused on small businesses, which may include family farms if a family farm is applying for commercial financing. One of the overarching concerns that we have with the proposed Regulations is that they are overly broad and impose greater restrictions on commercial transactions than they do for consumer transactions. Small businesses and consumers are different. The average small business is more sophisticated than the average consumer. They generally have a better understanding of commercial financing products compared to knowledge consumers have about consumer financial

products. Therefore, it does not make sense that the Regulations put more stringent requirements on commercial financing than what applies to consumer financing. The majority of the Regulations have stricter requirements for commercial financing than they do for the consumer financing products or services in SectionX.90009(c) ("Consumer Financing Regulations"). It does not make sense if the main reason for AB 1864 was to protect consumers, as this is a consumer protection bill first and foremost, that the protections for consumers would be less than for small businesses. Aside from the requirements in the Regulations differencing from the Consumer Financing Regulations, they also differ and are more restrictive than the Unfair, Deceptive, Abusive Acts or Practices ("UDAAP") of Section 1031 of the Dodd-Frank Act ("Dodd-Frank"). Put simply, it makes no sense for the DFPI to impose significantly more stringent standards on commercial financing than what applies to consumer financing. We also believe this violates the intent of the legislature.

III. SPECIFIC COMMENTS

a. Section X.90009.1. Unfair, Deceptive, or Abusive Acts and Practices

The Regulations require covered entities to refrain from certain actions, yet the Regulations fail to provide definitions to explain who is a covered entity and what that entity must refrain from doing. It is vital that additional definitions be included to provide clarity. Furthermore, all definitions should be listed within the Regulations.

(i) Section X.90009.1(a) uses the term "commercial financing" and defines it as having the same definition in subdivision (d) of Financial Code Section 22800 ("Section 22800"). However, Section 22800 is not final as the DFPI has not issued final regulations. Because there are no final regulations, the definition of "commercial financing" might not be finalized by the time this final Regulation is issued (the Section 22800 regulations may encounter issues with OAL or may be subject to litigation). We suggest this Regulation simply restate the definition in its entirety (and all related definitions) to avoid this type of issue.

(ii) Section X.90009.1(a) uses the term "small business recipients" but does not define the term anywhere in the Regulations. We would

suggest adding a definition. Moreover, it is confusing as the Regulations do provide a definition for “small business” in Section X.90009(b)(1), but that definition might be in contradiction to what a “small business recipient” means. Additional clarity is needed.

(iii) Section X.90009.1(a)(1)(A) states that an act or practice is unfair if it “violates another law.” This is not a requirement for the Consumer Financing Regulations, so it does not make sense why this would be a requirement for commercial financing. As the average small business owner is more sophisticated and has a better understanding of financial products than a consumer, there is no reason for commercial products to have more stringent requirements than consumer products. Moreover, Dodd-Franks does not generally provide that a violation of any other law is a UDAAP violation. If neither Dodd-Frank nor the Consumer Financing Regulations require this, why are more severe requirements being applied to commercial products?

(iv) Section X.90009.1(a)(1)(B) discusses the “harm” that may occur from an act or practice, but does not define or provide examples of what “harm” might actually entail. Nor does it list the types of considerations the DFPI should balance when deciding if there is harm. In the Consumer Financing Regulations, it states that the DFPI should look to see the “relative harm to the consumer, the frequency of the act or practice in question, and whether such act or practice is unintentional or stems from a technical, clerical, or nonmaterial error.” There is no such guidance listed in the Regulations or even a hint that the same type of balancing act would be taken into consideration. We would either suggest deleting this Section or providing more guidance and having additional criteria like those listed in the Consumer Financing Regulations.

(v) Section X.90009.1(a)(1)(C) defines an act as unfair, deceptive, or abusive if it violates “public policy.” Once again, the Consumer Financing Regulations do not have a public policy requirement and

therefore, the public policy requirement should not be imposed solely on commercial financing. Although Dodd-Frank references public policy, it simply states that "in determining whether an act or practice is unfair, the Consumer Financial Protection Bureau ("Bureau") **may** consider established public policies . . . ." (Emphasis added). If Dodd-Frank does not even require the Bureau to use existing public policy when determining if an act or practice is unfair, then why do the proposed Regulations require this? While the DFPI can assert that it wants to add additional protections, why are those protections only being applied to commercial financing and not consumer financing, when consumer financing should have more stringent requirements given the least sophisticated consumer standard. We would suggest deleting the public policy requirement, or have it follow the relevant language in Dodd-Frank.

(vi) Section X.90009.1(a)(1)(C) defines an act as unfair, deceptive, or abusive if it is "immoral, unethical, oppressive, unscrupulous, or substantially injurious to a person." First off, there is no definition of the word "person." Is person supposed to mean a "consumer" or is it a "small business?" A company is unable to comply with the Regulations if it does not know who specifically it must refrain from potentially injuring. Secondly, this is massively overbroad and will cause confusion. Similar language is not used for the Consumer Financing Regulations. This is a significantly more stringent requirement for a commercial financing product than what applies to a consumer financing product. Furthermore, there are no definitions or examples as what might be considered "immoral, unethical, oppressive, unscrupulous or substantially injurious." This wording is so broad that it could include anything. What is unethical is so subjective that it creates massive liability. Our country has progressed from the 1800s and courts and regulators have largely accepted they are generally not well equipped to make moral or ethical conclusions

about business activities. Many religions think it is immoral to charge any rate of interest. Because this section is so massively overly broad and more stringent than what is included in the consumer regulations, this section must be removed,

(vii) Section X.90009.1(a)(1)(D) states that there is a violation if an "injury" occurs but does not elaborate what would constitute an "injury." There is no definition, examples, or guidance as to what would be an "injury." This requirement is also not present in the Consumer Financing Regulations so it does not make sense why this would only apply to commercial products and not consumer financial products. Also, this Section is worded slightly different than Dodd-Frank. It would make more sense for this to be in line with Dodd-Frank so that the standard is the same and companies can have a better understanding as to what might constitute an injury if additional guidance is not provided by the DFPI. We would suggest having this be in line with Dodd-Frank.

(viii) Section X.90009.1(a)(2) states that "an act or practice is deceptive . . ." if a small business is "likely to be deceived by the act or practice." This is a cyclical statement that does not provide actual guidance or a definition of what constitutes a "deceptive" act or practice. It does not make sense to use the same word to define a word. There needs to be an actual definition of "deceptive" and examples so that a company is able to determine what the DPFI considers to be an actual deceptive practice or act. Also, in the Consumer Financing Regulations, the DFPI states that the terms "unfair" and "deceptive" are "consistent with Section 17200 of the Business and Professions Code and the case law thereunder." It does not make sense why this would be different considering there is already a statutory definition and defined case law. We would suggest the same definition as in the Consumer Financing Regulations or we would suggest that the definition of "deceptive" mimic that established under federal law and define it as

"(1) the representations, omission, acts or practices misleads or is likely to mislead the consumer, (2) the consumer's interpretation of the act or representation is reasonable under the circumstances, and (3) the representations, omission, act or practice is material." Furthermore, an act or practice should only be considered deceptive if the act or practice causes an injury. We would suggest adding language so that it reads "is likely to be deceived by the act or practice and suffers an injury as a result."

(ix) Section X.90009.1(a)(3)(A) states that a company cannot interfere with a business's ability to understand a term of conditions of a financial product or service. First of all, there is no definition as to what a "financial product or service is." It is important to make sure that all unique phrases and terms that are used are defined and are consistent throughout the Regulations. Furthermore, what constitutes interference? Is a small business's own ignorance of a term or condition considered interference? While numerous terms and conditions are obviously necessary in financing contracts, if a company does not simplify the language sufficiently but does the best they can, does that constitute interference on behalf of the company? Studies has shown most people (consumers and small business owners) do not understand APR. So if a commercial financing company provides an APR and the business does not understand what an APR is, is there liability? Moreover, this Section differs from Dodd-Frank as it leaves out the word "materially" prior to "interferes." It is important to add materially so that this should read "materially interferes with the ability . . ." as this would bring it in line not only with Dodd-Frank but also with the Consumer Financing Regulations, which state that the term "abusive" "shall be interpreted consistent with Title X of the Dodd-Frank Wall Street Reform…." There is once again no reason why commercial financing should have more rigorous requirements than consumer products.

(x) Section X.90009.1(a)(3)(B) discusses how a company is not allowed to take unreasonable advantage of a small business. This prohibition is broad and vague and does not provide any guidance as to what constitutes an unreasonable advantage as there are no definitions, examples or specifics. Why should a company be penalized if, unbeknownst to it, the small business had a lack of understanding. If a company asks a small business if it understands the costs and conditions of the financing and the small business answers in the affirmative, although in actuality it did not understand, is the company still liable? Where is the line drawn from what the company is told by the small business and how it relies on any statements by the small business? Furthermore, a company should not be in violation of the Regulations if there is no indication that the small business does not understand the terms. Also, what if another party, for example a broker of a commercial financing product, was the one engaging in the deception practices and acts and made a small business unreasonably relay on terms and costs that were not the actual terms and costs of the financing product. Is the financing company liable for the actions of a third party if it had no knowledge? It is imperative that additional guidance and clarity is provided.

b. Section X.90009.2. Commercial Financing Data

(i) As we have a CFL license, we are currently required to provide annual reporting on our loan products and any commission received as a broker. This is done as part of our annual report. It would make sense to have the reporting similar to what is required under our CFL license. That would mean that it would be reported in NMLS, as reporting is switching over in 2022 to NMLS. We would also suggest reporting occur at the same time as the CFL annual reports so that all information can be gathered and reported at the same time. This would make it easier for CFL licensees as it would only have to report once per year at the same time. We would also suggest that the data be

reported in a similar manner as data being reported for CFL annual reports.

(ii) Section X.90009.2(b)(2) requires the "total number and total dollar amount of transactions" to be reported. Additional clarification is needed as to what this entails. Also, definitions should be provided as to what is meant by the "total number" and "total dollar amount." It is important that a company is able to accurately provide the information and needs guidance and more specifics to do so. Is the "total dollar amount" what the small business must pay to the financing company or is it the amount that the company provides to the small business?

(iii) Section X.90009.2(b)(3) references the word "person" but does not provide a definition for "person." It is important to have definitions for all unique words and phrases.

(iv) Section X.90009.2(b)(4) requires the "minimum, maximum, average, and median total dollar cost of the financing…" but does not offer any additional guidance. What is the "total dollar cost?" Additional information and a definition is needed in order to understand what this number is.

IV. CONCLUSIONS

Thank you for considering our comments. We remain committed to working with you to implement regulations that provide value and are clear and easy to understand and implement. We hope you appreciate our comments. We would be happy to discuss these matters with you. You may reach me at [redacted].

Very truly yours,

[redacted]

Joseph D. Looney
General Counsel