



53 State Street
Floor 20
Boston, MA 02109
ashapiro@forwardfinancing.com

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Via e-mail to:
regulations@dfpi.ca.gov
@dfpi.ca.gov
@dfpi.ca.gov

Acting Commissioner Christopher S. Shultz
Department of Financial Protection and Innovation
Attn: Sandra Sandoval, Regulations Coordinator
300 South Spring Street, 15th Floor
Los Angeles, CA 90013

Re: Comments on Third Modification to Proposed SB 1235 Commercial Financing Disclosure Regulation (File no: PRO 01/18)

Dear Acting Commissioner Schultz:

Thank you for requesting comments on the third modification to the proposed commercial financing disclosure regulations ("Proposed Regulations"). Forward Financing LLC appreciates this opportunity to comment on the proposed regulations. This letter supplements our previous correspondence dated August 24, 2021 (attached).

Forward Financing provides sales-based financing to small and medium sized businesses nationwide. With such financing, customers can secure upfront capital in exchange for a certain percentage, typically 10%, of their monthly revenues until the amount purchased is remitted in full. Unlike a traditional, secured loan, if a customer's revenue decreases, its required periodic payments to us also decrease without the risk of losing collateral. In addition, our contracts expire after three years, limiting the period our customers are obligated to make payments. Moreover, we do not charge prepayment fees or penalties; rather, we provide prepayment discounts.

The fixed amount we charge allows our customers to easily determine the actual dollar amount the financing will cost, and the more frequent payment schedule ensures the business is not overwhelmed by large monthly payments.

Forward Financing supports disclosing material information about its sales-based financing to ensure its small business customers can make well-informed decisions. We agree with the Department's general disclosure objectives but believe the Proposed Regulations require some modifications in order to meet these objectives due to their complexity and the fact that they require disclosures that mischaracterize our products to take on the appearance of a traditional

loan. This will confuse customers, conceal customer protections, and force sales-based financiers to provide misleading information. Our comments below address several issues raised by the proposed regulations.

Financer Safe Harbor from Prosecution

Given the current state of the Proposed Regulations, the potential ambiguities in them, and the significant impact they will have on sales-based financing operations, the Department should provide a safe harbor from prosecution for financiers that make a good faith effort to comply. This will encourage financiers to adjust their business practices to provide the required disclosures to California small business customers rather than halting operations to avoid prosecution or penalty. If sales-based financiers cease funding in California, small businesses in the state would be stripped from having access to what often is their only means of financing.

To the extent a financer is found out of compliance with the Regulations, the Department should afford the financer an opportunity to demonstrate a good faith effort to comply. Such a demonstration could include an explanation of the financer's methodology and calculations used to generate disclosures, as well as other compliance items like internal policies and procedures. Upon demonstrating good faith, the financer should be afforded an opportunity to remediate the non-compliant practice without facing prosecution or paying penalties.

Recommendation: Financers that make a good faith effort to comply with the Proposed Regulations should receive a safe harbor from prosecution or penalty. Alternatively, if the Department is not inclined to provide a safe harbor as part of the Proposed Regulations, it should extend a safe harbor to financiers that make a good faith effort to comply for two years after the Proposed Regulations become final.

Itemization of Amount Financed

The "itemization of amount financed" disclosure (§ 956) is difficult to follow. As previously explained, Forward Financing does not charge customers with an upfront broker fee and does not deduct any broker fees from the funding it provides to its customers. Rather, we pay brokers out of our profits after consummation, i.e., out of the difference between the amount financed and the amount of future revenue we purchase from a customer after the deal closes.

Accordingly, the commission-based compensation Forward Financing pays to brokers is not a "prepaid finance charge" (§§ 900(a)(35), 956(a)(5)) because it is not a "separate" charge paid to Forward Financing by the customer and it does not decrease the amount of funding its customers receive. For this reason, it does not appear that an arrangement such as Forward Financing's will require disclosure under § 956(a)(5). However, it is unclear if that is what the DFPI intended.

Recommendation: Where a financer pays broker fees from its profits *after* a transaction is consummated, the Proposed Regulations should allow for disclosure in the format outlined in our previous correspondence. Alternatively, or in addition, the Proposed Regulations should state that broker fees paid from a financer's profits should not be included in the § 956 disclosure. As a further alternative, the Proposed Regulations should clarify how broker fees paid in the manner described above should be disclosed.

APR Disclosure and Calculation

APR is a financial metric generally associated with loans. Sales-based financing is not a loan. Requiring a loan-associated metric as part of a disclosure will cause customer confusion at the outset and should not be used as more thoroughly explained in our prior correspondence. As

discussed previously, there are key differences between a traditional loan and sales-based financing. For example, unlike a loan, where a business customer borrows money (often against pledged collateral), making an unconditional promise to repay the borrowed amount with interest over a fixed-term, sales-based financing is a discounted purchase of future revenue, with no set term (notwithstanding an expiration period like Forward Financing employs).

Despite these differences, the Proposed Regulations (§ 940) not only call for an APR disclosure, but they call for calculating APR for sales-based financing using Appendix J to Regulation Z (12 C.F.R. § 1026), “Annual Percentage Rate Computations for Closed-End Credit Transactions.” Although Regulation Z defines “closed-end credit” by exception: “consumer credit other than ‘open-end credit’” (12 C.F.R. § 1026.2(10)), the term itself and the inputs required for the Appendix J APR calculation are based on a fixed term or fixed payments over a fixed term. Further, the Proposed Regulations have separate disclosure requirements for “closed-end transaction[s]” (§ 910).

The methods outlined in Appendix J are not applicable and will not generate accurate results for sales-based financing that has neither fixed payments nor fixed periods. A business customer’s initial “payment amount” is based on its *estimated* future revenue, which is subject to fluctuation. Small business customers have the contractual right to reduce their payment amounts when their revenue decreases. Accordingly, payment amounts and the number of payments can and often do fluctuate, making sales-based financing inherently not “closed-end” or fixed-term. Almost half of Forward Financing’s customers reduce or pause their payments at some point during their payment period.

Recommendation: For the reasons set forth above and in our prior correspondence, we suggest not using APR in the sales-based financing disclosure. If APR remains in the disclosure, it should not be calculated using the methods outlined in Appendix J to Regulation Z.

Conclusion

As described herein and in our previous correspondence, Forward Financing supports clear, meaningful disclosures that help California small businesses make well-informed decisions about different types of financing options. Given the complexities of the Proposed Regulations and the need for additional revisions, we recommend issuing a further modified proposal for public comment before adopting final regulations.

We again appreciate this opportunity to provide comments and suggestions regarding the Proposed Regulations and thank you for your consideration of them. If you have any questions or comments, please contact me at [REDACTED] or by email at ashapiro@forwardfinancing.com.

Respectfully submitted,

[REDACTED]

Alexis Shapiro, General Counsel
Forward Financing LLC