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

October 27, 2021

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

Re: File No.: PRO 01-18 – Seventh Invitation for Comments on Proposed Rulemaking for Commercial Financing Disclosures ("Invitation")

Dear Commissioner Shultz,

Small Business Financial Solutions, LLC dba RapidAdvance ("RapidAdvance") would once again like to thank the California Department of Financial Protection and Innovation ("DFPI") for reaching out for input on the above proposed regulations ("Regulations"). RapidAdvance previously provided six in-depth comments to the informal requests for comments detailing a broad range of issues. In our previous comment letters, we provided a great deal of information regarding annual percentage rates ("APR") and the issues created by new Division 9.5 of the Financial Code (the "Code"). We request that our initial letters be reviewed again as they contain extensive information some of which the most recent version of the proposed Regulations still do not address.

While many of our prior comments have been addressed in the proposed Regulations, there are still important issues that remain that have not been addressed. We thank the DFPI for taking our comments into consideration. However, the proposed Regulations still fail to remedy a number of substantive issues that are necessary in order for the required disclosures to be clear, effective and not provide misleading information.

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. 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 most businesses have been shut down or negatively impacted since March, 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 don't 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. COMMENTS

A. Section Headings

The headers for each of the commercial financing sections are not uniform (*e.g.*, Closed-End Transaction Formatting and Content Requirements; Commercial Open-End Credit Plan Disclosure Formatting; Factoring Disclosure Format; Sales-Based Financing Disclosure Formatting; Formatting and Content Requirements for Lease Financing; General Asset-Based Lending Transaction Disclosure Formatting; and Disclosure Formatting for All Other Transactions). We suggest making the headings uniform (*e.g.*, Commercial Open-End Credit Plan Disclosure Formatting and Content, Factoring Disclosure Formatting and Content, Lease Financing Disclosure Formatting and Content, etc.). This would avoid some confusion as the different headings make it appear as if they should mean something different but they do not.

B. Definitions

Were appreciate the numerous changes you made to the definitions. Below we have some additional comments on the revised definitions. However, note that we think the definitions should be rearranged to be in alphabetical order as there are some that are still not in alphabetical order.

The following definitions should be revised to avoid confusion.

(i) Definition (a)(4)(A) - “At the time of extending a specific commercial financing offer” – The edits made to this Section are greatly appreciated. However, there are two additional edits that we believe are needed to avoid confusion. First, the disclosures should only be required when there is actually an offer that the applicant can select and the provider is willing to consummate if approved. As currently written, if a provider permits an applicant to select multiple offers to view based solely on applicant stated information (no verification of that information by the provider) and then the applicant selects one of those, disclosures would be required to be given when no information has been verified. This will lead to completely misleading information being disclosed as applicants are frequently incorrect about the data they input. We suggest the disclosure be provided once when the offer is selected by the applicant *and* the supporting information has been verified or revised based on a review of relevant information. It is important for the information to be verified so that disclosures are not required for more general inquiries where all data is self-reported by the recipient. Additionally, this would stop providers from having to make multiple disclosures for the same application as information is verified and corrected (which happens on virtually all applications). As currently drafted, a provider would be required to make the disclosures once a quote is selected and then every time unverified data is corrected due to the review of documents submitted by the recipient (assuming the correction will impact any of the required disclosures –which will be the norm). This will result in multiple disclosures being provided for the same transactions and cause confusion. This would make the disclosures more meaningful as they would be accurate each time they are provided as opposed to mere guesses based on unverified information. This issue can easily be addressed in the definition of "specific commercial financing offer" by adding a reference to data that is verified and not self-reported.

Second, the Regulations need to address early payoff discounts. In some circumstances, a provider might state that if a recipient repays the closed-end financing within a certain amount of time, the fixed fee is reduced. These types of discounts are given typically after the recipient agrees to a financing amount. Because these types of full-term fee discounts may increase the APR (but only if the recipient decides to execute the option) it is unclear how or if this should be addressed in the disclosures. An example would be a recipient gets a 10 month term loan with a fixed cost of $3,500 for an APR of 60%. However, the recipient is given the option of paying off the balance within the first 60 days and gets a discount of $1,500 (so the total cost would be $2,000 instead of $3,500 but the APR would be 75% given the reduced term). The proposed Regulations provide no guidance for this type of feature. These early payoff addendums are common in the industry so this issue should be addressed. Because of this, it is important to determine (i) whether or not a disclosure is required for early payoff addendums; and (ii) if a disclosure is required, how is it given and when (as it will conflict with the main disclosures and cause confusion). Our suggestion would be to expressly address this issue and not require a disclosure for discounts given as a result of early payment the recipient may choose to exercise but is not required to exercise.

(ii) Definition (a)(14) – "Irregular Payment" – An "irregular payment" is defined as anything that is not a "periodic payment." Our concern with this definition is that due to bank holidays or a potential bank account switch by the recipient, two or more payments might be collected on the same day. For example, a recipient makes regular contractual payments of $100 each business day but cannot make one on a bank holiday due to the bank being closed and the provider takes two payments ($200 total) the day after the bank holiday (that day's payment and the payment for the bank holiday). The $200 is contractually owed and represents two days' worth of payments, but that specific payment might be considered "irregular" under the definition as it is not the amount paid at regular intervals (definition of periodic payment). It would not make sense for this type of payment to be considered irregular as it is in the ordinary course of the contract and occurs due to a bank holiday. The definition should specify that this type of situation is not considered an irregular payment.

(iii) Definition (a)(22) – "Sales-based financing" – The proposed Regulations attempt to differentiate between closed-end transactions and sales-based financing, but there is still overlap that will create uncertainty as to what disclosures a provider should deliver. This differentiation is important to get right and make sure there is no confusion as the disclosures for sales-based financing include estimated APR and estimated term but closed-end transactions do not. Confusion will arise in connection with products that have hybrid repayment features where payments are based on sales revenue but there is also a minimum payment component that creates a "term" (the industry refers to this product as a variable payment amount loan). Many participants in the industry treat these products as closed-end loans with unique payment features. Because there is an actual term for these transactions, they generally fit within California's definition of a loan. This should not be confused with sales-based financing products with true-up features. These are different as the true-up feature may shorten or lengthen the estimated term of repayment. For these transactions, there is no fixed term. Under the proposed Regulations, both the variable payment amount loan and true-up sales-based financing would be required to give the sales-based financing disclosures. However, the variable payment amount loan should provide the closed-end transaction disclosure (as there is a fixed term and California law would treat the product as a loan). The confusion caused by the definition of "closed-end transaction" is caused by two clauses: (1) the reference to a "specific term" when sales-based financing has no specific term (this is why the disclosures refer to it as an estimated term); and (2) the inclusion of sales-based financing in the definition solely because there is a variable payment. As we have explained in numerous previous comment letters, this issue must be resolved or providers will be confused as to what types of disclosures to provide for certain products.

We suggest this issue be resolved by amending the definition of "closed-end transaction" and "sales-based financing" as follows:

1. Closed-end transaction means a transaction in which credit is extended only once over a specific term (including contracts that include an option in which the recipient may extend the term) or that the provider identifies as a loan, and is repaid:

A. In regular predetermined payments of specified amount over a fixed period of time; or

B. In a combination of variable payments and fixed minimum amounts so that the full amount is repaid during a fixed contractual term or where the contract requires all amounts be repaid by a specific date.

2. Sales-based financing means a commercial financing transaction that is not a closed-end transaction, that is paid by a recipient to the financer as a percentage of sales or revenue, in which the payment amount increases and decreases according to the volume of sales made or revenue received by the recipient and is not identified as a loan by the provider. Sales-based financing also includes commercial financing transactions that have a set payment amount that is based on a percentage of the recipient's sales or income but has a "true-up mechanism."

C. General Requirements

(i) Section 901(a)(8) takes our previous suggestion to make the columns more uniform so providers do not place disclosures on multiple pages in an attempt to hide costs. However, the "3:3:7" ratio is too prescriptive. While we agree that there should be limits on the ratio, something that is more flexible should be used. We suggest this be amended to state "the approximate ratio of 3:3:7." Requiring an exact ratio will be impossible to comply with as the ratios will always be off by very small amounts.

(ii) Section 901(a)(11) allows a provider to obtain a recipient's signature electronically. While this Section allows for a provider to use an electronic signature only if it adheres to California's electronic signature statute, it does not allow for a provider to use the federal ESIGN Act. This should be altered to state that a provider is able to use and comply with either given the federal ESIGN Act preempts the California law in most respects.

(iii) We suggest that somewhere in the disclosure language you add a statement that all disclosures assume and are based on timely payments and no default. This will reduce confusion in situations where a recipient defaults. Section 900(a)(4)(B) provides that there is no need to re-disclose in event of a default but nothing in the disclosure alerts the recipient that the disclosures assume there is no default and that additional charges may be imposed in an event of default. We suggest this be added to the disclosure form.

D. Funding Provided, Amount Financed and Recipient Funds

The various disclosures of the phrases "funding provided," "amount financed" and "recipient funds" are inconsistent, confusing and conflict with the statutory requirements. We will address the issues associated with each phrase and then propose revisions that believe will make the disclosures much more clear and avoid confusion.

Funding Provided and Amount Financed – The phrase "funding provided" is not defined anywhere in the Regulations. Instead, the phrase "amount financed" is defined (although the definition appears out of order) and appears to be used to simply replace the phrase "funding provided" everywhere except the label in the one specific column and row in the various disclosures. It is unclear to us why this was done as this will create material confusion. The Regulations don't actually include a disclosure labeled "amount financed." Rather, the "amount financed" is the dollar amount disclosed for the "financing provided" disclosure. However, the third column for this disclosure then has various references to the "amount financed" as if that phrase has been defined or used elsewhere in the disclosures. So the recipient is forced to assume the "amount financed" means the "funding provided." It makes no sense to require these types of assumptions be made by recipients. This problem is made worse by the fact that there is a separate disclosure of the "Itemization of Amount Financed" despite the fact there is actually no disclosed dollar figure called the "amount financed."[1] The inconsistent use of terminology is confusing, unnecessary and detracts from the intent of the statute. Additionally, the statute does not permit the disclosures to use the phrase "funding provided." Rather, SB 1235 requires disclosure of the "total amount of funds provided." Therefore, the use of the phrase "funding provided" does not match the statutory requirement.

We suggest the label "Funding Provided" be changed to "Total Amount of Funds Provided" to match the statutory phrase and that this phrase be defined (which would be the current definition for amount financed). We are not aware of any statutory authority that permits the Regulations to change the express proclamation of a statute regarding the label of a specific

[1] Note that TILA has an express disclosure called the "Amount Financed." Beneath that phrase in every TILA disclosure is the dollar amount of the amount financed. So there is no doubt that the amount financed is that dollar amount. Accordingly, when TILA requires an Itemization of Amount Financed, it is clear what dollar amount is being itemized. In the proposed Regulations, there is a dollar amount disclosure called "funding provided" but then recipients are forced to magically know that this is actually the "amount financed." The issue is then made worse by the fact that the Itemization of Amount Financed never refers to the "funding provided" disclosure. This issue is easily resolved by replacing all references to "amount financed" with "funding provided" (although we believe the statute requires the phrase be Total Amount of Funds Provided).

disclosure. Put simply, if the legislature required a disclosure be worded a specific way (which the relevant statute here does), the Regulations must use that phrasing. We also suggest the Itemization of Amount Financed be changed to be the Itemization of Total Amount of Funds Provided. These changes will make the Regulations consistent with the statutory requirements and make the disclosures less confusing to recipients as well as providers who must decipher and implement the Regulations.

Recipient Funds – The various disclosure forms make it clear that recipient funds is intended to be the amount of money actually provided to the recipient after all deductions and third-party payments. However, the definition of recipient funds is confusing. The first sentence refers to the amount of funds given directly to the recipient but the very next sentence states it excludes amounts paid to third parties. If an amount is paid to a third party it is not "given directly" to the recipient. As an entity that will be required to provide these disclosures we remain uncertain what amount you intend to be disclosed here. Providers can't be expected to make assumptions about basic disclosures like this and the Regulations should leave no doubt about what amount is to be disclosed as recipient funds. Additionally, the definition has numerous technical issues that are confusing (*e.g.*, referring to other financing amounts known to the provider but knowledge of an amount is irrelevant as all that is relevant is if any amount will be deducted from the Funding Provided to pay-off another balance, assuming a provider always knows the actual balance owed to a third-party, etc.). We suggest the definition of recipient funds be amended to state:

> "Recipient funds" means the amount given directly to the recipient by a provider in the form of cash, check, or electronic funds transfer to an account identified by the recipient. Recipient funds is calculated by taking the Funding Provided and deducting funds paid by the provider to third parties (including brokers), any portion of the Funding Provided used to pay off an outstanding balance of a pre-existing financing (either with the same provider or a third-party) and any other amounts deducted from the Funding Provided other than pre-paid finance charges. For the purpose of calculating recipient funds, if the provider does not know the actual amount to be paid to a third-party, the provider may rely on the amount the recipient identifies as being owed. Where the balance owed on an obligation may change over time, a provider may ignore a change in the balance that occurs after the initial disclosure is provided.[2]

[2] While we use the phrase "funding provided" throughout our proposed definition, it is only being used for consistency purposes to match the phrasing in the proposed Regulations. If the DFPI takes our comments and amends the phrase "funding provided" to "total amount of funds provided," which is consistent with SB 1235, our proposed definition should also be amended to change the phrase "funding provided" to "total amount of funds provided."

E. Broker Fees

In order to truly have the recipient understand the cost of the financing, it is important to include the amount of commission or fee that a broker is paid. Although the Regulations require certain broker commissions to be disclosed, they fail to address the manner in which the vast majority of broker commissions are paid. The majority of the time the financer pays the broker out of the financer's fees – not from the proceeds. The proposed Regulations only address the scenario where the broker is paid from the proceeds (which is not how it is done most of the time). Therefore, the disclosures as currently drafted are ineffective in identifying to recipients what a broker is getting paid in the majority of transactions. Because broker commissions are usually included in the cost of the financing, recipients do not know what a broker is being paid. The broker fee is typically the most expensive third-party fee associated with a transaction and would be valuable information for a recipients to know. Accordingly, it should be separately itemized and disclosed. For a recipient to truly understand the full cost of the financing, it is imperative that the provider be required to disclose the broker commission to the client. We suggest that this be included in the final Regulations. Please see the additional discussion of broker compensation below. Alternatively, at least permit it to be disclosed as it is currently prohibited from being itemized.

F. Specific Disclosure Forms

1. Closed-end Transactions (Section 910)

(i) Payment (Section 910(a)(6)) – Our comments above regarding irregular payments are relevant to this section as well (please see comments above). It is important to provide clarification as to how make-up payments should be handled so that providers know how to accurately give the disclosures. Once again if a provider is to assume that it can collect on all bank holidays, when in actuality it cannot, it knows that the payment after the holiday will be for two days. That should not be a variable payment under the Regulations.

(ii) Prepayment (Section 910(a)(8)(9)(10)) – SB 1235 only requires a "description of prepayment policies." As each provider may have a different policy based on the product, the proposed disclosures do not work and require more than SB 1235 permits. TILA chose to require a simple statement about prepayment penalties as opposed to requiring disclosure of amounts because doing so creates confusion. For example, the proposed Regulations refer to prepayment fees being fees other than accrued interest. What is accrued interest?

There is no definition or guidance as to what constitutes “accrued interest.” In an environment such as commercial lending where there is no applicable maximum rate, no rate calculation restrictions or state prepayment requirements, the parties are free to contract when “interest” accrues. In a fixed fee transaction, the contract can clearly state that all fees are earned on day one and therefore accrue immediately upon closing of the transaction. In this scenario, all “interest” has accrued as of the end of day one and there is no prepayment penalty. As such, under the proposed Regulations, a provider could legally disclose that there are no prepayment fees if the contract provides all fees are earned on day one. The recipient is then further misled by the disclosures when the next row provides that there are no additional fees for prepayment. In this scenario the disclosures make it appear as if there is a discount for repaying early when there is in fact no such discount. Given this, we believe the better approach with respect to prepayment penalties is to have a more definitive statement about them rather than a calculation and a disclosure amount that can be easily manipulated. We suggest you follow TILA’s lead here and simply require the following disclosure: “There is no discount or rebate for paying early,” “Paying off early will save you fees” or “Please review your contract carefully to better understand the benefits, if any, of paying off early.”

(iii) Average Monthly Cost (Section 910(a)(11)) – As we have reiterated numerous times in past comment letters, the “average monthly cost” for a non-monthly pay product should not be required. The disclosure of the monthly cost for a non-monthly pay product does not implement, interpret, or make specific any provision of SB 1235. Requiring this disclosure will not only be inconsistent with SB 1235 but it will do more harm than good. In fact, this disclosure was never proposed by Senator Glazer and was never included in any of the model forms Senator Glazer prepared for the hearings and debates on SB 1235. In fact, this disclosure was expressly considered and rejected when the legislation was being drafted. In addition to this disclosure simply not being permitted under SB 1235, adding it would frustrate the purpose of SB 1235 as it detracts from other disclosures that the California Legislature deemed to be more meaningful. SB 1235 requires only the “method, frequency and amount of payments,” and a disclosure of a monthly cost for a non-monthly pay product is not the actual amount of the payment or the frequency of the payment per the financing contract. The addition of this disclosure frustrates the purpose of SB 1235. It is unclear how disclosing an inapplicable and hypothetical payment amount would be useful information to a recipient. More importantly, the disclosure seems likely to cause confusion given that the information would conflict with the written terms of the commercial financing agreement. Moreover, the disclosure of the average monthly cost is disclosed before the actual payment frequency in the proposed disclosures. This is extremely problematic because the first payment amount disclosed is not the actual payment amount. We would highly recommend this disclosure be removed as it is not necessary or permitted. Because this regulation is inconsistent with the statute enacted by SB 1235, it violates the APA Consistency standard.[3] The regulation also violates the APA Necessity standard.[4] The regulation is not within the scope of authority granted by SB 1235, in violation of section 11342.1 of the APA. It is not reasonably necessary to effectuate the purpose of the statute, in violation of section 11342.2 of the APA.[5]

2. Commercial Open-End Credit Plan Disclosure Formatting (Section 911)

(i) Funding Provided (Section 911(a)(3)(A)(B)(C)) - Please see our comments above.

(ii) Estimated Payment (Section 911(a)(7)) – Please see our comments above.

(iii) Prepayment (Section 911(a)(10)(11)(12)) - Please see our comments above.

(iv) Average Monthly Cost (Section 911(a)(13)) - Please see our comments above.

3. Sales-Based Financing Disclosure Formatting (Section 2065)

(i) Funding Provided (Section 914(a)(2)(A)(B)(C)) - Please see our comments above.

(ii) Estimated Payment (Section 914 (a)(6)) - Please see our comments above. In addition to our concerns over what constitutes a periodic payment or a variable payment, we are also concerned about how true-ups are handled in this Section. Most providers do not have scheduled true-ups listed in the contracts. The majority of providers allow for the flexibility of the recipient to reach out to the provider to request a true-up or for the provider to initiate a true up if they have documented proof of a change in revenue. Because of the flexibility that is built into most true-up provisions, it would be impossible for a provider to disclose this at consummation as it is unknown.

(iii) Prepayment (Section 914 (a)(9)(10)(11)) - Please see our comments above.

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[3] CA Government Code § 11349(d)
[4] CA Government Code § 11349(a)
[5] CA Government Code § 11349(a)

(iv) Average Monthly Cost (Section 914 (a)(12)) - Please see our comments above.

G. Estimates – Sales Based Financing – Historical Method (Section 930)

Section 930(b)(2) states that the provider "shall fix the number of months used to calculate the recipient's average monthly historical sales, income, or receipts for all transactions or by recipient industry or financing amount (or both), provided that the period of historical data used by the provider shall not be less than four (4) months or more than twelve (12) months." As stated in previous comment letters, even if a provider requests a certain amount of statements, it does not mean the recipient will provide all months requested. The use of the word "fix" in this Section will require providers to collect statements for a minimum amount of months. This scenario was taken into account in Section 930(b)(4)(B), which allows a provider to be able to calculate the historical monthly sales based on what was provided by the recipient if the recipient fails to provide revenue data for all the requested months. But this wording seems to contradict the use of the word "fix." We believe this is just a drafting error and Section 930(b)(2) should simply be amended to state that the provider "shall request the number of months used to calculate . . . ." Additionally, there should be no limitations on how many months a provider requests as long as they are consistent and following written underwriting policies. This change would also address the issue for renewal transactions. The proposed Regulations would apply the same four (4) or twelve (12) month limit to renewals but in many cases only one (1) month is needed for that (and in some cases no months are needed). For a renewal, the provider already has performance data from the recipient as well as older bank/processing statements and should not be required to ask for more when they will not be used. The provider should be allowed to request whatever amount of statements it deems necessary to underwrite the transaction (no more and no less). Moreover, to insure that a provider is not just picking a random number of statements, this Section should require a provider to request a certain number of statements based on its internal policies and require a provider to have written policies to address this. For example, a provider could state in its policies that it only requires four (4) months bank statements for restaurants but six (6) months for trucking and maybe only one (1) month for all renewals.

Furthermore, Section 930(b)(4)(A) allows a provider to exclude from the average calculation certain months where there were "less than the average monthly sales . . . ." While we understand the intent is to exclude outlier months, it does not make sense to exclude only months that are less than the historical norm. Including only outlier months that are greater than the historical average will cause the provider to take more revenue every day and be more of a burden on the recipient. We suggest that the language be changed to allow a provider to exclude any month that is materially greater or less than the average monthly sales.

H. Estimated Annual Percentage Rate – Sales-based financing (Section 942)

There is a requirement in Section 930(a)(4) and (b)(4) to account for payments required when the timely payments fall below a contacted for threshold. The previous version of this section referred to penalty payments. We submitted a comment and highlighted the issues this creates. It appears you may have edited this pursuant to our comment but the same issue still exists. Payments that fall below a contacted threshold are in effect breaches of an agreement, so any payment in relation to that is a penalty payment. It is unclear to us what you are trying to address here. The wording still needs to be fixed to make it clear that payments related to a default (which would include payments falling below a contracted threshold) are not included in the payments or APR disclosures. It is impossible for the provider to know what "penalty fees" will be charged or how often they will be charged as they have no idea if there will be a default or "penalty" or if there is a default or penalty, how many times it will happen. We suggest that (a)(4) and (b)(4) be deleted as they do not make sense to be used in this calculation and conflict with other provisions of the proposed Regulations.[6]

I. Duties of Financers and Brokers (Section 952)

Section 952(a)(2) requires that a financer maintain a copy of the "evidence of transmission of the disclosure." There is no description as to what would constitute "evidence of transmission." Would a copy of the sent email or facsimile be sufficient or is there something else specifically that the DFPI is looking for the provider to maintain? Moreover, in the event the broker fraudulently creates an "evidence of transmission," is the provider liable for storing that transmission or not being able to determine if it is fraudulent? Just as a waiver of liability is given to brokers for potentially providing recipients with misleading or incorrect disclosures created by a provider, a provider should be provided with a waiver of liability if the broker fraudulently creates the transmission or alters it in anyway.

Section 952(f) provides brokers with certain protections such as not requiring a broker to evaluate the accuracy of any disclosure, nor transfers liability to a broker if the disclosure is not

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[6] Section 900(a)(4)(B) makes it clear that the disclosure rules do not "apply to changes made to resolve a recipient's default on a financing contract."

compliant and limits broker liability if a broker makes a statement based on the disclosure that was provided. However, there are absolutely no protections for financers for any wrongdoings of brokers. What happens if a broker creates a false transmission and the financer relies on the transmission? Or what if a broker alters the disclosure that a financer provides to the broker to give to the recipient? If a financer is not aware of any of these wrongdoings, it should not be held liable. This just invites brokers to not adhere to the requirements because they can potentially shift any blame to the financer. Moreover, it will pull financers into unnecessary litigation when a financer had nothing to do with a broker's wrongdoing. It does not make sense for a broker to obtain protections under the Regulation and a financers to receive no protections. A financer should be given the following protections: (i) a financer should not have to evaluate the accuracy or validity of an evidence of a transmission by a broker; (ii) a financer should not be liable in the event a broker alters a disclosure or gives a recipient a false or altered disclosure; and (iii) limit any liability for a broker falsely and misleadingly describing a disclosure or the commercial financing to a recipient.

J. Tolerances (Section 955)

Section 955(a)(2) discusses "irregular payments." Please see our prior comments regarding irregular payments when the payment is a make up for a bank holiday, etc. Those comments should be taken into consideration so that providers are able to determine if the APR that is being disclosed is going to have irregular payment tolerances or other non-irregular payment tolerances.

Section 955(b) only limits provider or financer liability when an inadvertent error is made and the provider or financer catches that error. Once again we would argue that this liability limitation should also be extended if a recipient discovers the inadvertent error, notifies the provider or financer and the provider or financer makes the appropriate adjustments and refunds any overpayments based on that disclosure within 60 days of being notified by the recipient.

K. Funding Recipient Will Receive (Section 956)

In Section 956(a)(3) it states that a provider can state in generic or general terms what type of party is being paid through part of the recipient funds. We would suggest that this be more generic and just be stated as "total amount of third-party payments." This way it would cover all payments and make it so the disclosure will be easier to calculate and view.

Sections 956(c)(1) and (c)(2) could be read to conflict with one another. Section 956(c)(1) requires that the itemization appears in a document separate from the other disclosures. However, Section 956(c)(2) then states the itemization must immediately follow the other disclosures. We presume you mean that it must be in next page of information provided. If so, that will create problems. Most of these disclosures will be provided electronically. So when the main disclosures are reviewed and then signed, the recipient will likely stop scrolling through the electronic document and submit it. That means they will likely never see the itemization. This issue does not exist in TILA as TILA does not require the disclosures to be signed. We highly recommend you permit the disclosures to be part of the same document with the main disclosures being separated from the itemization (as TILA does) and the signature appearing below the itemization.

L. Calculation of Annual Percentage Rate (Section 940)

As we have argued in the other comment submissions we have provided on this topic, we do not believe APR is the best metric and will actually cause more confusion. We incorporate our prior comments provided to you into this letter. However, given the continued inclusion of APR in proposals, we once again have the following comments on this section.

Section 940(c) should be amended so that the "minimum on-time" payments exclude any payments that have been made due to default.

Section 940 covers the calculation of the APR and states that the APR will be calculated in accordance with Appendix J, 12 C. F. R. Part 1026 (effective December 30, 2011). This reference raises two material points:

1. It does not address amendments. If Appendix J is amended, are providers to ignore any such amendments and follow the language that exists as of December 30, 2011? It seems this section should incorporate amendments after December 30, 2011.
2. Part 1026 specifically covers only closed-end transactions. It does not apply to open-end transactions. This is a material problem as the proposed Regulations will require open-end products to use TILA closed-end calculations. Considering TILA has specific calculations for open-end credit, we suggest the APR for open-end products be calculated in accordance with the open-end sections of TILA (See 12 C.F.R. § 1026.14).

The manner in which APR is addressed under the proposed Regulations creates inherent conflicts with TILA's APR. You can now have a consumer and a business get the exact same financing offer (one under TILA and one under the proposed Regulations) and the APR will be different.

You can also have a business get the exact same product offering but one from a bank and one from a non-bank and the APR will be different (the bank will likely follow TILA's calculations). We believe this will create material confusion.

M. Preemption

As stated in our past 6 comment letters, which are incorporated by reference herein, the proposed Regulations are preempted by TILA. APR and "finance charge" are terms of art created by TILA and have different meanings than how they are defined in the Regulations. The goal of SB 1235 is for businesses to be able to compare products, and because of APR calculations will differ between consumer and commercial products and even between providers offering commercial products, the goal of SB 1235 is defeated. We once again request that the proposed Regulations not require the disclosure of an APR or Estimated APR. This inconsistency will result in misleading disclosures of credit choices, thwarting Congress' primary objective in enacting TILA. The regulation violates the APA Consistency standard.

N. Broker Compensation

It is imperative that the DFPI add broker compensation as a disclosure. We would like to reiterate our prior comments as this is an important disclosure for small businesses. Based on how the Regulations are drafted, it appears the DFPI either (i) has decided to ignore broker compensation that is paid by a financer directly to a broker rather than from recipient funds, or (ii) misunderstands how the majority of financers compensate brokers for referrals. In either case, the Regulations should be revised so that the amount and manner of compensation a broker receives for a commercial financing transaction is clearly disclosed to a recipient.

For the majority of commercial financing transactions that occur today, the broker is compensated by receiving a commission that is paid from the provider's funds. Unlike the manner envisioned by the Regulations, the commission payment is not deducted from the recipient's funds and paid to the broker. Rather, the financer pays the commission payment to the broker with its own funds. To recoup the amount paid to the broker, the commission amount is included as part of the finance charge and collected by the financer during the term of the transaction. As a result, as currently drafted, the Regulations do not require a disclosure for this type of broker compensation. Accordingly, the proposed Regulations will not require (or even permit) a provider to disclose a broker fee paid by the provider despite the fact this is an essential disclosure for recipients and something they want to see. By requiring the broker fee payment to be hidden in the finance charge, you are precluding recipients from having the necessary information to negotiate betters terms. Because the broker fee is included in the finance charge, the APR increases and recipients will wrongly believe that the financer is getting all the finance charge, when in actuality the broker is getting a significant portion of the cost of the financing. In order to solve this problem, the Regulations should require the financer to disclose the amount of commission that the financer is paying the broker so that the recipient has a full understanding of the costs of the financing.

O. Timing for Comments

You only gave us eleven business days to provide comments. These Regulations are extremely complex and the calculations require significant mathematical effort. These very short time frames to comment preclude us from actually testing some of the more complicated mathematical issues. Such short time frames also preclude us from drafting model forms to see how they look and if terms make sense in context. We strongly suggest you provide longer comment periods so we can address all outstanding issues and think through the more complicated issues.

III. CONCLUSION

Thank you once again for considering our comments. As always, we remain committed to working with you to implement regulations that provide value to small businesses. We hope you appreciate our comments. We are motivated to make sure the final regulations work, provide value and assist small businesses. 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