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CEO & SECRETARY
RICHARD GUMBRECHT,
SECURED FINANCE NETWORK

November 22, 2021

Via E-Mail: [redacted]@dfpi.ca.gov
[redacted]@dfpi.ca.gov
regulations@dfpi.ca.gov

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

Re: Comments on Proposed Regulations for implementation of Commercial Financing Disclosure Regulations

Dear Commissioner:

The Secured Finance Network (formerly known as the Commercial Finance Association) ("SFNet") is the international trade organization founded in 1944 representing the asset-based lending, factoring, trade and supply chain finance industries, with 270 member organizations throughout the State of California, the U.S., Canada and around the world.

As we have stated in previous comment letters, we continue to be grateful for your openness in discussing with us our concerns regarding the disclosure requirements under Commercial Finance Disclosures enacted under SB1235 (Chapter 1011, Statutes of 2018) and signed into law by Governor Brown on September 30, 2018 ("Disclosure Requirements") as well as the regulations proposed by the California Department of Financial Protection and Innovation regarding compliance with the Disclosure Requirements ("Proposed Regulations"). We have read the latest revisions to the Proposed Regulations. While we have no comments aimed directly at the most recent amendments, we would like to take this opportunity to reiterate our concerns over the challenges these regulations will pose to our members and the resulting unintended consequences, which we believe will adversely affect both the small businesses that provide commercial financings and the small businesses that look to obtain a commercial financing.

We appreciate the changes made to address some of the concerns we have raised with prior versions of the Proposed Regulations, but many of our most urgent requests have not been

addressed, particularly concerning APR and a safe harbor. We are attaching our past comment letters for reference.

We would be happy to speak with you at your convenience about these requests.

Sincerely,

Richard Gumbrecht
Chief Executive Officer
Secured Finance Network

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CEO & SECRETARY
RICHARD GUMBRECHT,
SECURED FINANCE NETWORK

October 27, 2021

Via E-Mail: [redacted]@dfpi.ca.gov
[redacted]@dfpi.ca.gov
regulations@dfpi.ca.gov

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

Re: Comments on Proposed Regulations for implementation of Commercial Financing Disclosure Regulations

Dear Commissioner:

The Secured Finance Network (formerly known as the Commercial Finance Association) ("SFNet") is the international trade organization founded in 1944 representing the asset-based lending, factoring, trade and supply chain finance industries, with 260 member organizations throughout the State of California, the U.S., Canada and around the world. As we have stated in previous comment letters, we continue to be grateful to your openness in discussing with us our concerns regarding the disclosure requirements under Commercial Finance Disclosures enacted under SB1235 (Chapter 1011, Statutes of 2018) and signed into law by Governor Brown on September 30, 2018 ("Disclosure Requirements") as well as the regulations proposed by the California Department of Financial Protection and Innovation regarding compliance with the Disclosure Requirements ("Proposed Regulations"). We have read the latest revisions to the Proposed Regulations and appreciate the changes made to address some of the concerns we have raised with prior versions of the Proposed Regulations. We continue to have some concerns with the Proposed Regulations and SFNet and its members strongly urge you to take the below comments and suggestions into account with respect to the Proposed Regulations.

DISCLOSURES FOR CHANGES TO COMMERCIAL FINANCINGS

Although Section 900(a)(4)(B) of the Proposed Regulations was changed in the latest round of revisions to address certain ambiguities, it continues to provide that disclosure will be required subsequent to the consummation of the commercial financing contract if the

contract is "amended, supplemented or changed" and the resulting change would result in an increase in the annual percentage rate. Without repeating our discussions with the DFPI, it is important to note that factoring and asset-based credit facilities are designed to provide working capital for the recipient and, therefore, have to adapt to the working capital needs and fluctuations of the recipient, which results in **frequent** changes and accommodations provided to the recipient.

Our members have universally indicated that they **often** receive requests for additional capital from their borrowers to satisfy a temporary working capital need. This could be due to a large order received by the borrower or other large expenditures such as a need to replace or add new equipment. This need for additional capital would be satisfied by the provider through a temporary increase in the commercial financing or similar accommodation which is accomplished through amendments, supplements or changes to the financing agreement, triggering a need to provide a disclosure under Section 900(a)(4)(B) of the Proposed Regulations.

It is very important to point out that in the above situation, the recipient is not looking to multiple sources of financing and is simply reaching out to its current provider to satisfy its additional capital requirements. As such, a disclosure by the provider does not serve the intended purpose of providing information that the recipient can use to compare financing products. This can simply be addressed in the Proposed Regulations by only requiring a new disclosure if the recipient has informed the provider that it is seeking financing proposals from multiple providers or the recipient requests one in order to compare financing products.

It is also important to point out that the fees and charges with respect to a temporary accommodation like the one outlined above can be fairly small. For example, the provider may seek a documentation or similar fee of a few hundred dollars. Strictly read, the Proposed Regulations would require a new disclosure even if an immaterial fee is to be paid by the recipient. This issue can be addressed by having a fairly immaterial threshold for redisclosure related to such fees. For example, the Proposed Regulations could state that if the APR is increased because a fee of less than $1000 is to be paid, a new disclosure requirement will not be triggered.

As is evident in the above comments, our members are concerned that a disclosure requirement triggered by amendments, supplements or changes to an existing financing can become burdensome due to the nature of the financing products our members provide and the frequency of changes that occur during the term of the financing. As such, we strongly request that the DFPI make efforts to limit the disclosure requirement related to such changes to material changes rather than all changes that may impact APR regardless of materiality.

A few additional ways in which the re-disclosure requirement may be tailored to provide more useful information to the recipient while staying in line with the public policy:

(1) <u>Excluded Avoidable Fees and Expenses</u>. In many instances when changes are made to a financing, they are due to a request by the recipient. In the above, example, it is the recipient who is asking for an accommodation to the credit

facility to obtain additional liquidity necessary to fulfill a customer order. We request that an exception be included in the regulations for re-disclosure due to increases in the financing charge due to the charging of avoidable fees that were charged due to a modification, supplement or change made at the request of the recipient.

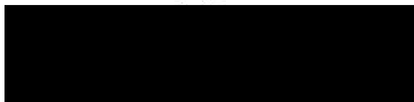
(2) Exclusion for Ordinary Course Changes. As discussed above, all businesses, small and large, will have ebbs and flows and a financing provided to such business will have to adapt to these changes. There will be ordinary course modifications to a factoring facility or asset-based facility which should not trigger a re-disclosure as these changes could happen often and create a burden on the financier and confuse small businesses at a time when the small business is not looking for new financing or the ability to compare one financing product against another financing product. We request an exclusion for re-disclosure related to changes in the financing if the changes are in the ordinary course of business.

SAFE HARBOR

Despite the great efforts put into drafting thoughtful Proposed Regulations, including allowing for a tolerance in Section 3026 with respect to the information disclosed, because of the numerous assumptions required to allow factors and asset-based lenders to provide an APR calculation, even the best estimation and assumptions could result in a margin of error greater than the tolerance level provided. We continue to strongly urge the DFPI to provide a safe harbor for providers of commercial loans to small business which insulates the providers from liability (through litigation or otherwise), if these providers comply with the Disclosure Requirements in good faith. Additionally, if the DFPI believes that it is not able to provide for a safe harbor due to the language in the statute setting forth the Disclosure Requirements, we urge the DFPI to communicate the need for a safe harbor to the legislature. Such a safe harbor would be very similar to safe harbors contained in the Federal Truth-In-Lending Act for consumer lending disclosures. Specifically see 15 U.S.C. § 1640(b) and 15 U.S.C. § 1640(c). As we have previously indicated, the safe harbor is necessary because many of the providers of commercial loans to small businesses are small businesses themselves and can't absorb the cost of litigating perceived violations of the Disclosure Requirements when they are acting in good faith in their compliance.

We appreciate the opportunity to comment and will make ourselves available for continued discussions with the DFPI as this process progresses.

Sincerely,



Richard Gumbrecht
Chief Executive Officer
Secured Finance Network

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PRESIDENT
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FIRST VICE PRESIDENT
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BOBBI ACORD NOLAND
PARKER, HUDSON, RAINER & DOBBS LLP

CEO & SECRETARY
RICHARD GUMBRECHT,
SECURED FINANCE NETWORK

October 27, 2020

Via E-Mail: regulations@dbo.ca.gov
[redacted]@dbo.ca.gov

Department of Business Oversight, Enforcement Division
Attn: Charles Carriere, Counsel
1515 K Street, Suite 200
Sacramento, California 95814-4052

Re: Comments on Second Modification to Proposed Text of Regulations for Implementation of Commercial Financing Disclosures

Dear Mr. Carriere:

The Secured Finance Network (formerly known as the Commercial Finance Association) ("SFNet") is the international trade organization founded in 1944 representing the asset-based lending, factoring, trade and supply chain finance industries, with 270 member organizations throughout the State of California, the U.S., Canada and around the world. As we have previously discussed on multiple occasions, SFNet and its membership are supportive of providing as much information as possible to small businesses in order to assist them in making an informed decision on which financing product is right for them. However, SFNet and its members continue to have concerns regarding the disclosure requirements under Commercial Finance Disclosures enacted under SB1235 (Chapter 1011, Statutes of 2018) and signed into law by Governor Brown on September 30, 2018 ("Disclosure Requirements") as well as the regulations proposed (including the second modification to the proposed text) by the California Department of Business Oversight regarding compliance with the Disclosure Requirements ("Proposed Regulations").

SFNet and its members strongly urge you to take the below comments and suggestions into account with respect to the Proposed Regulations. Although the Disclosure Requirements and Proposed Regulations have implications with respect to many forms of financial products provided by our members, we specifically direct you to the implications on factoring and asset-based lending as those implications are potentially detrimental to these members and may result in less commercial financing products being available in California.

FACTORING:

Although the Proposed Regulations seek to provide information with respect to a factoring facility in a manner that creates uniformity with other types of financing, Factoring is not a financing product that can be easily compared to a normal commercial loan and the number and type of assumptions necessary to put it into similar terms as other financing products, make the disclosures meaningless, provide information that in no way helps small business in evaluating the cost of factoring against other financing options and creates optics that incorrectly suggest Factoring is extremely expensive. As such, the disclosures provided by factors under the Proposed Regulations will put factors at a disadvantage, which would discourage borrowers from accessing this important source of capital (today used by over 1,000 CA businesses) and result in factors not providing factoring facilities in California. Below is a summary of the issues:

1) Second Row Disclosures - APR. Simply put, factoring facilities are the transfer of an account receivable to the financing provider for consideration. Regardless of when the customer pays the account receivable, the consideration paid will be a certain amount determined based on a discount applied to the face amount of the receivable. Although in many instances interest is not charged in this transaction, the Disclosure Requirements and the Proposed Regulations impose on the factor the requirement to artificially come up with an interest rate in order to calculate the APR. In such cases, the assumptions necessary to artificially create an APR disclosure will result in a percentage which will not accurately reflect the cost of the factoring facility provided to the small business while potentially creating a meaningless percentage which could be a multiple of the actual cost of the facility. This will result in an undue burden on the factor by inaccurately suggesting that the factoring facility is an expensive source of financing and therefore not a viable choice for the small business when, in fact, the factoring facility may be a better option than other financing alternatives. We suggest that the regulations for this row be modified to allow the factor to explain that no interest rate will be charged and therefore an APR is not applicable.

2) Third Row Disclosure – Finance Charge. This disclosure requires that all "finance charges" be disclosed with finance charges being defined under the regulations promulgated for the Federal Truth in Lending Act. Those regulations define finance charges as any fees and charges imposed by the provider as "an incident to or a condition of the extension of credit." This would include any documentation fees, initial due diligence fees and expenses and any other fees and expenses that come up on the closing of a factoring facility. To apply 100% of these fees to one hypothetical invoice and measure the APR based on that one invoice would skew the APR in a way that would be significantly disadvantageous to a provider and make the disclosure meaningless. We suggest that the provider be allowed to pro rate these fees based on a 12-month term and only include the portion that falls within the period of the hypothetical invoice.

3) Fourth Row Disclosure – Payments. As the source of funds to repay an account receivable that is subject to a factoring arrangement come from the customer to the small business, the provider of a factoring facility may not be looking to the small business to make any payments. As such, we strongly urge that this row simply be deleted for transactions where the provider is not looking to the small business to make any payments. Its inclusion creates confusion for small businesses as it introduces a concept that does not apply to factoring.

4) Sixth and Seventh Row Disclosure – Early Prepayment. This disclosure creates confusion for small business as factoring arrangements are generally not subject to early prepayment. Early payment by the small business does not generally occur as the funds used to pay the factor may come from payments made by the customer of the small business on the accounts receivable which is transferred to the factor pursuant to the factoring arrangement. In order

to avoid this confusion, we suggest that language be added to this row similar to the following: "A legally enforceable claim which has been transferred pursuant to this transaction may be transferred to the recipient upon the payment of an amount mutually agreeable (including any fees applicable thereto) between the recipient and provider."

ASSET-BASED LENDING

As with factoring, asset-based lending is a form of finance that has unique differences that cannot be uniformly compared to other sources of capital. Therefore, to avoid similarly discouraging this important source of funding we urge you to adopt the following changes.

1) First Row Assumptions. The Proposed Regulations suggest that the provider make the assumptions based on a hypothetical single lump sum draw on the credit facility and that no other advances will be made during the life of the facility. This is simply not in-line with reality and any calculations based on this assumption will result in presenting unhelpful information to the recipient, which will confuse the recipient rather than help them decide what facility is better suited to their needs. Since asset-based lending transactions are revolving, the small business and provider expect that the small business' continuing working capital needs will result in a loan to always be outstanding. Therefore, providers of asset-based transactions will underwrite the facility taking into account an average monthly outstanding principal balance. This amount will be based on the monthly liquidity needs of the small business and other information obtained from the small business by the provider. Calculating the disclosures using this "average monthly outstanding" calculation will result in more realistic and useful information to be disclosed to the recipient. Additionally, as drafted, the language requires that the provider assume a set amount of daily collections. This is also not in-line with reality as collections are generally "lumpy," meaning that there could be substantial collections on one day and no collections for many days to follow. Many businesses have a seasonal aspect and will have a substantial amount of payments from customers while they receive very little to no payments in other months. Using the average monthly outstanding balance simplifies the assumption and removes the need to make two arbitrary assumptions for the outstanding balance and daily collections.

2) Third and Fourth Row Disclosures. Similar to the comments above to the factoring disclosures, there are a number of fees and financing charges that may be charged on the initial closing date of the facility for due diligence, collateral examinations, appraisals and other matters which, if applied to one lump sum advance, would significantly skew the APR calculation. We strongly suggest that these fees and expenses be allowed to be annualized.

ASSET-BASED LENDING AND FACTORING

1. Please note that factoring facilities often provide for advances against other types of collateral of the borrower in addition to purchases of factored receivables. These additional elements are advances or loans against items of collateral and are not purchases of legally enforceable claims. Thus, the definition of "approved advance limit" in § 2057(a)(1) needs to be modified to account for this by adding the following at the end of the definition:

   "If the agreement also provides for the financer to pay different maximum advances for different categories of advance (such as advances secured by inventory or intellectual property), the approved advance limit shall also include in addition to the above the sum of the different maximum advances for each category of advance."

2. Related to the change proposed immediately above, a corresponding change needs to be made to § 2071(a)(3)(A)(iii). This subparagraph should be revised as follows (deleted language highlighted):

   "(iii) The parties to the factoring transaction agree in writing prior to execution of their agreement that at some point during the agreement, an amount exceeding $500,000 is reasonably expected to be advanced to the recipient ~~for legally enforceable claims that have not yet been paid~~."

3. The definition of "approved credit limit" in § 2057(a)(2) needs to be modified as follows (change occurring at the end of the definition):

   ". . . and advances with respect to one category of advance do not reduce the maximum advance for another category of advance, the approved credit limit means the sum of the different maximum advances for ~~different types of legally enforceable claims~~ [*added language follows*] each category of advance."

4. With respect to both factoring and asset-based lending transactions, the agreements are often structured so that the financer has the discretion to extend advances. The transactions are often not committed facilities. Thus it is incorrect to state that the financer is "required to pay" the advances. To account for discretionary advances, the definitions of "approved advance limit" in § 2057(a)(1) and "approved credit limit" in § 2057(a)(2) need to be modified by: (i) adding the parenthetical "(or has the discretion to pay)" after the phrase "required to pay", which phrase appears in each definition, and (ii) adding the parenthetical "(or the financer has the discretion to pay)" after the phrase "requires the financer to pay", which phrase appears in each definition.

5. As written, it is still unclear when §2057(a)(4)(A) applies. It could be read to apply to cover subsequent financings to the same recipient although it appears that it is not the intent. Subsequent financings are covered under §2057(a)(4)(B). To clarify this, §2057(a)(4)(A) should be revised as follows:

   "Except for the time described in subparagraph (a)(4)(B) below, the time when a specific amount, rate or price, in connection with a commercial financing, is quoted to a recipient, based on information from, or about, the recipient; and"

6. §2057(a)(20) should be revised by adding the following at the end of such subparagraph:

   ""Recipient" shall mean and be interpreted as to any recipient (considered the "first recipient") to include any other recipient that controls, is controlled by, or is under common control with the first recipient."

   Commercial financings are often provided to related recipients or co-recipients. The test as to whether the disclosure requirement applies should be at the aggregate level for recipients related by common ownership not at the individual recipient level. For example, assume the approved advance limit for one recipient is $550K and for a related recipient the approved advance limit is $200K. Under current rules, the first recipient would not need to be provided the disclosure but the second one would. The proposed change would eliminate the requirement for the second recipient, which is appropriate from a policy standpoint given the two recipients in this example are related by common ownership and the law already does

not require the disclosure for the recipient that has the larger approved advance limit. Thus the protections afforded by the disclosure are not needed for the second recipient.

7. There are factoring transactions that are "non-borrowing", meaning that the factor does not advance funds against factored receivables. There is no credit extension to the factoring client. For a small commission (a factoring fee), the factor simply purchases the receivables and assumes the credit risk thereon. If the receivable is unpaid by the account debtor due to the account debtor's financial inability to pay (i.e. credit risk) the factor absorbs the loss -- the factoring client does not. However no funds are advanced against the receivables in a non-borrowing factoring arrangement. It should be made clear that no disclosures are required to be made in non-borrowing factoring transactions. To address, this § 2071(a)(3)(B) should be revised as follows (added language underlined):

   "(B) If the factoring transaction does not meet all of the requirements listed in subparagraph (a)(3)(A) above, the commercial financing offer shall be considered less than or equal to $500,000, except with respect to a factoring transaction where the approved advance limit is $0, in which case such commercial financing offer for such factoring transaction shall not be subject to these regulations."

8. § 3010(a)(3) should be revised by adding the following phrase immediately after the term "face value" in the first line of such subparagraph: "(net of any available prompt payment discount, volume discount, cash discount, trade discount or other discount or rebate offered by the recipient to the account debtor)".

9. § 3021(a)(2) should be revised by adding the following term immediately after the phrase "up to and including" in the second line of such subparagraph: "a specified" and deleting "an".

10. § 3022(b) should be revised by adding the following term immediately after the phrase "up to and including a" in the second line of such subparagraph: "specified".

BENCHMARK RATE

LIBOR is expected to be sunset on December 31, 2021. While there is still ongoing discussion among industry participants as to LIBOR's replacement rate, it appears that the replacement rate will be some variation of the Secured Overnight Funding Rate (SOFR). Thus, the definition of "benchmark rate" in §2057(a)(5) should be revised by adding the following phrase within the parenthetical: "Secured Overnight Funding Rate (SOFR)".

SAFE HARBOR

Although this letter attempts to clarify many of the issues and challenges posed by the Proposed Regulations, both SFNet and its members continue to urge both the DBO and the California Legislature to provide, either through additional legislative action or by the enactment of regulations, a safe harbor for providers of commercial loans to small business which insulates the providers from liability (through litigation or otherwise) if they comply with the Disclosure Requirements in good faith. This would be very similar to safe harbors contained in the Federal Truth-In-Lending Act for consumer lending disclosures. Specifically see 15 U.S.C. § 1640(b) and 15 U.S.C. § 1640(c). The safe harbor is necessary because many of the providers of commercial loans to small businesses are small businesses themselves and can't absorb the cost of litigating against a plaintiff bar in California, which will see the Disclosure Requirements as creating a potential cause of action for

them and their clients. Once the plaintiff's bar becomes active in seeking damages from the providers of loans to small businesses, it will be a matter of time before many of the providers, which are small businesses themselves, go out of business, impacting the availability of credit to small businesses in California.

TREATMENT OF DEPOSITORY INSTITUTION AFFILIATES:

The Disclosure Requirements and Proposed Regulations continue to include any non-depository subsidiaries or affiliates and subject them to the Disclosure Requirements. Subsidiaries of depository institutions are generally not depository institutions themselves, but are regulated nevertheless. SFNet and its members strongly believe that depository institutions should be defined to include those affiliates and subsidiaries which are regulated and subject to regulatory oversight whether or not they are depository institutions.

The definition of "provider" in §2057(a)(19) should be revised by adding the following new clause (C):

"(C) A provider excludes: (i) any financial or bank holding company doing business under the authority of, or in accordance with, an approval issued by the United States, or (ii) any wholly-owned subsidiary of the foregoing or of a depository institution, that in each case is authorized to transact business in this state."

Please note this exclusion only applies to 100% owned subsidiaries and affiliates of bank holding companies or depository institutions. These entities are highly regulated by a number of different federal banking supervisors and agencies, including the FRB, the OCC, the FDIC and the CFPB. The "wholly-owned" requirement ensures that only highly regulated affiliates are excluded. Lesser-owned affiliates, who are not highly regulated and thus from a policy standpoint should not be excluded, are not excluded.

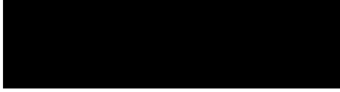
ECONOMIC IMPACT

To quantify the impacts that we suggest may occur above, SFNet polled its members as to how they would adjust their lending practices in California, if at all, in response to the enactment of the Proposed Regulations. Many of the members found the Proposed Regulations very confusing and difficult to comply with. 56% indicated they would only engage in deals over $500,000 in California. 12.5% of those that responded stated that they would cease lending in California and 12.5% said that they would curtail their lending in California. This suggests that there will be a material limitation on the availability of factoring and asset-based credit facilities to small businesses in the state if a simplified compliance process isn't set forth for these providers to comply with the Disclosure Requirements.

Additionally, as stated above, if the Proposed Regulations result in artificially inflating the cost of factoring and asset-based lending facilities in the state of California, many small businesses may choose financing sources which are, in fact, more costly and avoid factoring and asset-based facilities to their detriment. This will have the opposite result of the stated policy behind the enactment of the Disclosure Requirements.

We hope that our comments above are helpful in crafting the final regulations with respect to the Disclosure Requirements and are happy to discuss the above issues with you at any time.

Sincerely,



Richard Gumbrecht
Chief Executive Officer
Secured Finance Network

January 22, 2019

Via E-Mail: **regulations@dbo.ca.gov**
[redacted]**@dbo.ca.gov**

Department of Business Oversight, Legal Division
Attn: Mark Dyer, Regulations Coordinator
1515 K Street, Suite 200
Sacramento, California 95814-4052

Re: Comments on Proposed Rulemaking Commercial Financing Disclosures (PRO 01-18)

Dear Mark Dyer:

The Commercial Finance Association (the "CFA") is the international trade organization founded in 1944 representing the asset-based lending, factoring, trade and supply chain finance industries, with 260 member organizations throughout the State of California, the U.S., Canada and around the world. Although the CFA and its membership are supportive of providing as much information as possible to small businesses in order to assist them in making an informed decision on which financing product is right for them, the disclosure requirements under Commercial Finance Disclosures enacted under SB1235 (Chapter 1011, Statutes of 2018) and signed into law by Governor Brown on September 30, 2018 ("Disclosure Requirements") will create obstacles for our members who provide financing products to small businesses in California and, as a result, will discourage funding in the state.

Our members strongly urge you to take the below comments and suggestions into account when enacting the rules and regulations for compliance with respect to the Disclosure Requirements. Although the Disclosure Requirements have implications with respect to many forms of financial products provided by our members, we specifically direct you to the implications on factoring and asset-based lending.

FACTORING:

CFA members continue to have concerns over the application of the Disclosure Requirements to Factoring. Simply put, factoring is a sale of an account receivable by the recipient to the provider at a discounted rate, allowing the small business to be paid on its accounts receivable quickly rather than wait for the invoices to be paid by its customers 30-120 days later. For example, a small business may assign an account receivable with a face value of $100,000 with a payment term of 60 days to a Factoring provider for 85% of the face value ($85,000) and therefore receive a portion of the account receivable on the first few days after its creation rather than wait 60 or more days to receive payment with the remainder of the account receivable (minus the factor's fees and commissions) to be paid to the small business once the account receivable is actually collected. Factoring facilities can be structured to be on an invoice-by-invoice basis, cover only invoices generated by sale to certain customers or some small business may sell every account receivable that they generate. The discount rate varies and is based on the credit risk of the customer that owes the account receivable.

The challenge with applying the Disclosure Requirements to Factoring facilities is that the disclosure items are not ones that can be determined without some material assumptions which are unknown at the time the Disclosure Requirements are to be submitted to the provider's clients. Below is an analysis of each problematic disclosure item as applied to Factoring (Using the terminology from the statute for clarity, the lender is the "provider", the borrower is the "recipient" or "small business" and the party that owes accounts receivable to the recipient is the "customer"):

(1) Total Amount of Funds Provided: The number and amount of accounts receivable purchased depend on the sales volume of the recipient. The more goods and services the recipient sells, the more accounts receivable it would have available to sell into a Factoring facility.
(2) Total Dollar Cost of the Financing: The discount rate and/or factoring fees as described above depends on the credit risk of each customer who owes an account receivable to the recipient. An account receivable owed by Walmart will be sold at a higher purchase price (or a low commission, as applicable) while an account receivable owed by another small business will have a larger discount rate (or a high commission, as applicable). This put together with the volume of accounts receivable described in (1) above, makes it impossible to determine a total dollar cost.
(3) Method, Frequency and Amount of Payments: The repayments on the Factoring facility are made when the customer who owes the account receivable pays its debt. The only information available on when that account receivable gets paid is the payment term which is on the face of the invoice issued by the small business. Although the payment terms are determined by the small

business, it is the customer that decides when to pay and it may pay before or after the actual due date of the invoice.

(4) A Description of Payment Polices: As set forth above, there are no payment policies applicable to the small business as the accounts receivable subject to a Factoring facility are paid by the small business' customers.

(5) Total Dollar Cost Expressed as an Annual Rate: For the same reasons that the total amount of funds provided and total dollar cost of the financing is not possible to calculate as set forth above, an APR is also not something that can be calculated without material assumptions as to the number of accounts receivable sold, the aggregate amount of the accounts receivable, the fees and expenses with respect to the financing facility and the discount rate with respect to each account receivable.

As we expressed to Senator Glazer and his staff on behalf of our members in the drafting and deliberation stage of SB1235 our members continue to believe that Factoring facilities should be exempted from the Disclosure Requirements. However, we do acknowledge that certain of our members that provide cash advance facilities which may inaccurately label such credit facilities as Factoring facilities should be distinguished from true Factoring facilities and subjected to the Disclosure Requirements.

Cash advance facilities or merchant cash advance facilities are loans provided to small business which are then repaid using the future collections of credit card receivables or other accounts receivable of the small business. The provider does not purchase the account receivable and takes a security interest over the future sales collections of the small business and puts into place a periodic (often daily or weekly) automatic debit from the small business' deposit accounts to repay the loans. Such facilities are sometimes incorrectly labeled as Factoring facilities and to properly subject them to the Disclosure Requirements, they should be defined and separated from Factoring. A suggested definition:

> Merchant Cash Advance means a financing option extended to a recipient by a provider which is repaid by the recipient through a sale of all or a portion of its future sales collections and which is repaid through periodic automatic payments taken from the recipient's bank accounts in a pre-determined amount.

Alternatively, if the DBO determines that Factoring facilities should be subjected to the Disclosure Requirements, we propose that the provider be allowed to satisfy the Disclosure Requirements by providing to the recipient a summary of the applicable discount rates and material fees and commissions. This will allow the recipient to determine the invoice by invoice cost associated with a Factoring facility and to make an informed decision rather than be confused by material assumptions designed to allow a provider to comply with the Disclosure Requirements.

ASSET BASED LOANS:

Our members have some similar concerns with application of the Disclosures Requirements to Asset-Based Lending Transactions. However, we think that with the proper rules, such providers can comply with the Disclosure Requirements and provide meaningful information to the recipients through such disclosures.

The initial concern with the Disclosure Requirements is the way Asset-Based Lending Transaction is defined. The current definition is very vague and does not accurately identify such loans. Simply put, an asset-based facility is one where the amount of the loans available to be borrowed are a percentage of the primary collateral securing such loans. The current definition seems to limit such loans to those based on accounts receivable but the reality in the industry is that asset-based loans may be made based on a variety of assets, including accounts receivable, inventory, equipment, or any other business asset of realizable value. Therefore, a definition similar to the below would be a more accurate definition:

> "Asset-based lending" means a commercial financing in which a provider advances loans to a recipient which (i) repayment obligations are secured by collateral consisting of certain assets of the recipient including accounts receivable, payment intangibles, cash receipts, inventory or equipment and (ii) the amount of the loan is equal to a percentage of the value of some or all of the assets securing its repayment.

In addition to the definition, providing accurate information pursuant to the Disclosure Requirements (even through examples) may be very challenging because of the number of variables involved in disclosing accurate information. For your understanding, below is a list of many of such variables:

(1) Borrowing and Repayment. Asset-based facilities are generally structured as open ended revolving credit facilities and recipients generally borrow as the need arises. Some recipients may borrow as frequently as daily in some situations. Since these loan facilities are generally used to provide working capital to the recipients, the facilities are used in the same frequency as a recipient would access bank accounts to pay for day-to-day activities. Also, it is common for the recipients to have all payments on accounts receivable remitted to the provider in order for prompt application to the outstanding loans in order to pay down the facility and increase borrowing capacity. As such, the amount of the loan can fluctuate wildly through daily borrowings and daily repayments.

(2) Interest. Interest rates are generally variable and determined based on a certain margin above an index rate (which is generally the prime rate, LIBOR or a similar index rate). The potential variable nature of the interest rate put together with the frequently fluctuating principal balance makes an annual estimation of interest to be paid an impractical task.

(3) Unused Line Fee. The providers generally have to set aside funds up to the proposed amount of the loan facility to be able to quickly make loans to a recipient as the need arises. Because the providers have to have such funds reserved and ready to be loaned to a recipient, they incur a certain cost of funds. To the extent those funds are not borrowed by the recipient, the provider passes on its cost of funds through an "unused line fee." Based on the same rationale set forth above, the frequent fluctuations in the outstanding balance of the loans makes it nearly impossible to determine the unused line fee to be paid over a given period of time.

(4) Float/Clearance Days. As payments come in to pay down the principal balance of the loans (in many instances on a daily or fairly frequent basis as demonstrated above), providers generally charge "float" or "Clearance Days." Such fees are calculated as the continued charging of interest on the amount repaid for a short period of time (generally 1-3 days) after the payment is received as though the payment was not received until the end of the period of time. The difficulty with determining this fee over a future time period is that neither the provider nor the recipient can estimate with any meaningful accuracy as to when the customers will be paying their accounts receivable, which gets applied to the loan outstanding amount.

(5) Other Fees. There are other fees that go into the calculations necessary to comply with the Disclosure Requirements that are difficult to determine because they are based on greatly fluctuating calculations. One example is the "Collateral Monitoring Fee" which is a fee paid by the recipient to the provider to recover the cost and expense it incurs in managing the underlying collateral which is the basis for the asset-based loan. For example, when accounts receivable are the basis for the loan, the issuance and payment of receivables need to be tracked in order to confirm the amount of loans available to the recipient. The fee charged for this is based on the aggregate amount of the outstanding accounts receivable. Depending on the recipient's business, it may generate a large amount of receivables in one month and very few the next. As such, calculating this fee over a future period of time is nearly impossible.

These challenges all suggest that a great deal of thoughtfulness needs to go into determining how to allow asset-based lenders to comply with the Disclosure Requirements while allowing them to provide meaningful information. We appreciate that the statute allows compliance by example of a sample transaction, but as is evident with the number of variables set forth above, simply picking a single borrowing under an asset-based loan and making a number of assumptions to ignore the above described fluctuations will most likely provide useless information to the recipient and further confuse them

rather than provide meaningful information to allow them to decide on the best financing option for their needs.

Therefore, we propose that the rules and regulations being considered allow asset-based lenders to comply with the Disclosure Requirements by having a very detailed list or description of contract terms clearly setting forth or describing the interest rate index and margin and all of the fees that the recipient is required to pay. This list or description will be subject to negotiation between the parties and will be signed by both provider and recipient. Additional language can be added to this list or description in order to give an example or explanation of how the interest rate and each of the fees are calculated in order to give the recipient meaningful information it can use to determine its best option.

LIMITATION ON LIABILITY:

A very material concern expressed by our members is the potential for litigation against them in the event that they satisfy the Disclosure Requirements through examples (which as stated above will require for certain assumptions) and it is later determined that the examples provided were significantly different than the actual cost of the financing because of the number of variables involved in the above-referenced types of financing. In such a situation, recipients backed by an active plaintiff's bar in California could use the good faith effort of the provider to comply with the Disclosure Requirements as an offensive tool in litigation. Once such litigation occurs, we are certain that the Disclosure Requirements will have an impact on small business lending in California as many small business lenders (which are small businesses themselves) will stop lending to small businesses in California rather than risk the cost and burden of litigation.

Therefore, we request that the DBO provide rules and regulations to make it clear that a cause of action is not available to recipients based on the disclosures made by example so long as such examples are provided in good faith by the providers.

AFFILIATED ENTITIES:

In some situations, the providers that are providing financing which are subject to the Disclosure Requirements are subsidiaries and affiliates of depository institutions. Often, these subsidiaries and affiliates are themselves regulated entities and are under state and federal regulator oversight. Due to such oversight, these providers are generally "good actors" in the industry and the Disclosure Requirements should not apply to them. As such, we suggest the addition of the following language to the rules and regulations being promulgated to exclude such subsidiaries and affiliates:

The following to be excluded from the Disclosure Requirements: "any affiliate or related entity of a depository institution that is supervised by the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the applicable state banking regulator or any combination of the foregoing."

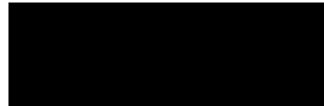
Affiliate defined as follows: "Affiliate" shall mean, in relation to a depository institution, any other person controlled, directly or indirectly, by such depository institution, any person that controls, directly or indirectly, such depository institution or any person directly or indirectly under common control with such depository institution. For this purpose, "control" of any person or depository institution means ownership of a majority of the voting power of the person or depository institution.

SIZE OF COMMERCIAL FINANCING SUBJECT TO DISCLOSURE REQUIREMENT:

As stated in the statute, the Disclosure Requirements apply to a "commercial financing offer by a provider that is equal to or less than five hundred thousand dollars ($500,000)." This language is vague as it relates to open-ended (revolving) credit facilities. In our meetings with Senator Glazer's office prior to the passage of SB1235 we were told that the intent is for open-ended credit facilities to only be subject to the requirements if the maximum credit limit of the facility is equal to or less than $500,000. We request that the DBO clear up the confusion and make the intent of the drafters clear that in an open-ended credit, the maximum credit facility limit is the amount used to determine whether the Disclosure Requirements apply to such commercial financing. Without such clarification in the regulations (1) the language could be read to suggest that if the maximum limit is less than $500,000 but the facility is drawn and repaid so many times that the aggregate amounts loaned over a period of time exceed $500,000, the financing facility will not be subject to the Disclosure Requirements and (2) on the flip side, the language could be read that if you have a financing facility with a maximum credit limit significantly higher than $500,000 but the recipient only draws a small amount (< $500,000), the financing facility will be subject to the Disclosure Requirements. Many large multi-national corporations obtain large corporate revolving credit facilities which they plan to maintain for a time of need but expect to never utilize, such facilities may be subjected to the Disclosure Requirements under the second scenario above. Neither of the two scenarios set forth above reflect the intent of the drafters as disclosed to us by the drafters prior to the passage of SB1235.

We look forward to working with you as you consider comments received with respect to the Disclosure Requirements. We appreciate the opportunity to comment and reiterate our requests with respect to compliance by our members providing factoring and/or asset-based credit facilities and will make ourselves available for continued discussions with the DBO as this process progresses.

Respectfully,



Richard Gumbrecht, CEO
COMMERCIAL FINANACE ASSOCIATION