



## **Revenue Based Finance Coalition Comments on Proposed Regulations Under the California Consumer Financial Protection Law Regarding Commercial Financial Products and Services PRO 02-21.**

The Revenue Based Finance Coalition (“RBFC”) is comprised of responsible finance companies that provide needed capital to small businesses through innovative methods. RBFC members offer accounts receivable purchase financing to small businesses and some members also engage in lending in the state of California through a California Financing Law (“CFL”) license. Our members also include select vendors that provide technology services to the small business finance industry. This letter responds to the Department of Financial Protection and Innovation’s “Notice of Proposed Action Under the California Consumer Financial Protection Law Regarding Commercial Financial Products and Services PRO 02-21.”

The RBFC applauds the Department’s efforts to protect California businesses from unfair, deceptive, and abusive acts and practices (“UDAPP”) in commercial financing. However, the RBFC respectfully asks the Department to consider striking the section of its proposed regulations that would require providers of commercial financing to annually report the “total cost of financing” to the Department.

### **The Department’s Proposal to Require Providers of Commercial Financing to Annually Report the “Total Cost of Financing” Lacks Necessity Under the APA.**

#### **I. The APA’s “Necessity” Standard.**

Under the California Administrative Procedure Act (“APA”), the Department’s regulatory actions must satisfy each of the following six substantive standards: (1) clarity, (2) necessity, (3) consistency, (4) authority, (5) reference, and (6) nonduplication.<sup>1</sup> The “necessity” standard means:

The record of the rulemaking proceeding demonstrates by substantial evidence the need for a regulation to effectuate the purpose of the statute, court decision, or other provision of law that the regulation implements, interprets, or makes specific, taking into account the totality of the record.<sup>2</sup>

The APA further requires an agency’s accompanying “initial statement of reasons” (“ISOR”) to include:

(1) A statement of the specific purpose of each adoption, amendment, or repeal; (2) the problem the agency intends to address; and (3) the rationale for the determination by the agency that each adoption, amendment, or repeal is reasonably necessary to carry out the purpose and address the problem for which it is proposed.<sup>3</sup>

#### **II. The Purpose of the California Consumer Financial Protection Law.**

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<sup>1</sup> Cal. Gov’t Code Ann. § 11349.

<sup>2</sup> Cal. Gov’t Code Ann. § 11349(a).

<sup>3</sup> Cal. Gov’t Code Ann. § 11346.2(b)(1).

The California Consumer Financial Protection Law (“CCFPL”) provides as follows:

The purpose of the California Consumer Financial Protection Law shall be to promote consumer welfare, fair competition, and wealth creation in this state by doing all of the following:

- (1) Promoting nondiscriminatory access to responsible, affordable credit on terms that reasonably reflect consumers’ ability to repay.
- (2) Promoting nondiscriminatory access to consumer financial products and services that are understandable and not unfair, deceptive, or abusive.
- (3) Protecting consumers from discrimination and unfair, deceptive, and abusive acts and practices in connection with financial practices and services.
- (4) Promoting nondiscriminatory consumer-protective innovation in consumer financial products and services.<sup>4</sup>

Although this is a broad statement of purpose, as applied to commercial financing the CCFPL is narrow. Only the following language in the CCFPL applies to commercial financing:

- (e) The department, by regulation, may define unfair, deceptive, and abusive acts and practices in connection with the offering or provision of commercial financing, as defined in subdivision (d) of Section 22800, or other offering or provision of financial products and services to small business recipients, nonprofits, and family farms. The rulemaking may also include data collection and reporting on the provision of commercial financing or other financial products and services.<sup>5</sup>

Accordingly, the Legislature intended to keep the Department’s authority under the CCFPL narrow as applied to commercial financing by singling out only one application of the CCFPL to commercial financing.

## II. The Department’s Proposed Data Reporting Requirement.

The Department has proposed the following data reporting requirement for a “covered provider” of commercial financing:

- (b) On or before March 15 of each year, each covered provider shall file electronically through the department’s website a report verified by an authorized officer and containing the following information for activity during the preceding calendar year:
  - (1) The covered provider’s identifying and contact information, including name, any fictitious business names, entity type, mailing address, phone number, email address, website address, and designated contact person.
  - (2) By type of commercial financing or other financial product or service, the total number and total dollar amount of transactions with covered consumers.

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<sup>4</sup> Cal. Fin. Code § 90009.

<sup>5</sup> Cal. Fin. Code § 90009(e).

(3) By type of commercial financing or other financial product or service, the number of transactions with covered consumers for the following amounts financed: \$10,000 or less, over \$10,000 but not over \$25,000, over \$25,000 but not over \$50,000, over \$50,000 but not over \$100,000, over \$100,000 but not over \$250,000, over \$250,000 but not over \$500,000, and over \$500,000. The covered provider shall determine the amount financed in a transaction according to the definition of “amount financed” in the regulations adopted under Financial Code section 22804.

**(4) By type of commercial financing or other financial product or service and for each interval described in paragraph (3), the minimum, maximum, average, and median total cost of financing expressed as an annualized rate. The method of calculating the total cost of financing expressed as an annualized rate for a given type of commercial financing or other financial product or serve shall be the same method used in complying with the regulations adopted under Financial Code section 22804.<sup>6</sup>**

(c) A covered provider who reports information to the commissioner under Financial Code section 22159 of the California Financing Law shall not report that information to the commissioner under this section.<sup>7</sup>

IV. The Department’s Explanation of Why Requiring Annual Reporting of the Total Cost of Financing is “Necessary” under the APA.

In its ISOR, the Department states as follows:

**Section 1062, subdivision (b)(4),** requires filers to provide, by type of commercial financing or other financial product or service and for each interval described in subdivision (b)(3), the minimum, maximum, average, and median total cost of financing expressed as an annualized rate, where the method of calculating the annualized rate for a given type of financial product or service is the same method used in complying with the regulations adopted under Financial Code section 22804. The purpose of this provision is to specify the information that covered providers must provide in the annual report. **This information is necessary because it will help the Department better understand the cost of commercial financing and other financial products and services to covered consumers. When aggregated, the information will allow the Department to compare covered providers and the various types of commercial financing. Collecting this data will increase accountability and transparency regarding the availability and cost of credit. Over multiple reporting periods, the data will help identify trends.** Allowing covered providers to use the same calculation method that they used in complying with the commercial financing disclosure regulations is necessary because it

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<sup>6</sup> Note that the requirement for a commercial financing provider to calculate and disclose an “annualized rate” sunsets on Jan. 1, 2024.

<sup>7</sup> Proposed regulations section 1062 (emphasis added).

avoids imposing additional regulatory burdens on covered providers who are also subject to those requirements.<sup>8</sup>

V. Analysis.

The APA's ISOR provision requires the adoption of a regulation to (1) be reasonably necessary to carry out the purpose of the statute and (2) address the problem for which it is proposed.

**Requiring commercial financing providers to annually report data on the "total cost of financing" is not reasonably necessary to carry out the purpose of the CCFPL for the following three reasons:**

1. Under the APA's necessity standard, an agency must show substantial evidence that the need for a regulation effectuates the purpose of the statute. The purpose of the CCFPL's single provision on commercial financing is to protect small businesses by eliminating UDAAP. Requiring disclosure of the total cost of financing does not achieve this goal because UDAAP is embedded in activities, compliance systems and procedures of providers, rather than the numeric cost of financing. The collection of data on the total cost of financing provides no useful information in evaluating provider's UDAAP practices, therefore, it is not reasonably necessary in achieving the purpose of the CCFPL.
2. The Department states that collecting data on the cost of financing is "necessary because it will help the Department better understand the cost of commercial financing and other financial products and services to covered consumers." The purpose of the CCFPL is not to regulate the cost of commercial financing and other financial products and services to small businesses. The cost of commercial financing is regulated under the CFL.<sup>9</sup> As a result, there is no reasonable necessity under the CCFPL to collect data on the cost of financing.
3. The Department explains in the ISOR that the purpose of requiring annual reporting of the total cost of financing is "to improve accountability and transparency in California marketplace and to protect California residents from abuses." However, the Department already has achieved this goal and provided guidance for enforcement under its UDAAP authority by defining UDAAP in its proposed regulations. In response to comments received in the rulemaking process, the Department has largely adopted the Consumer Financial Protection Bureau's definition of UDAAP. By adopting this widely known and court-tested definition of UDAAP, the Department had provided comprehensive interpretation based on well-developed federal case law. This UDAAP analysis does not impact the cost of financing. As a result, it is unnecessary to require annual reporting of the total cost of financing.

**Requiring commercial financing providers to report data on the "total cost of financing" fails to address the problem for which it is proposed for the following two reasons:**

1. Total cost of financing data will not assist the Department in understanding a provider's compliance with UDAAP or any other small business financing laws because there is no statutory limit to the cost of financing for a bona fide commercial loan made by a CFL licensed lender or to

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<sup>8</sup> Available at <https://dfpi.ca.gov/wp-content/uploads/sites/337/2022/06/PRO-02-21-Initial-Statement-of-Reasons.pdf> (emphasis supplied).

<sup>9</sup> See Cal. Fin. Code § 22251(c).

the cost of financing that is not a loan, such as revenue-based financing.<sup>10</sup> In particular, section 1062, subdivision (b)(4) of the proposed regulations requires annual reporting of the minimum, maximum, average, and median costs of financing. It is unclear how such information is useful in protecting small businesses because there is no standard cost of financing or any applicable statute for the Department to compare the total cost of financing against. Without a standard for the total cost of financing, this data provides nothing helpful to the Department's analysis. Therefore, the collection of data on the total cost of financing does not address the problem of UDAAP.

2. Total cost of financing data will not provide information for detecting and assessing risks to small businesses, as required under § 90019(b) of the California Financial Code. Section 90010(b) authorizes the Department to obtain reports from providers for the purpose of "detecting and assessing risks to ... small business...." However, detection and assessment are forward-looking activities, and those activities can hardly be based on past reports of the total cost of financing. If a small business had agreed to the cost of financing, the business presumably evaluated and consented to the terms of the agreement. Relying solely on the past cost of financing information, the Department will not be able to detect and assess the particular risk at the time of the transaction, especially when risk should be evaluated on an individual-basis. Therefore, the inclusion of costs of financing does not serve the purpose of detecting and assessing risk to small businesses and it should not be required in an annual report.

Furthermore, it is unclear whether "[t]he record of the rulemaking proceeding demonstrates by substantial evidence the need for a regulation," as required by the APA.<sup>11</sup> By using the language "substantial evidence," the Legislature intended the record to provide more than mere conclusions in supporting the particular enactment of the regulations. Although we agree with the Department that UDAPP could undermine the public confidence, we failed to locate in the Department's rulemaking file substantial evidence supported by facts and analysis that demonstrates the need for requiring commercial financing providers to report data on the "total cost of financing."

We respectfully request that the Department strike the requirement that providers of commercial financing annually report the total cost of financing. We look forward to further engaging and working with the Department to promulgate reasonable rules that are consistent with the CCFPL, other applicable laws, as well as a competitive marketplace.

Sincerely,



Deveron Gibbons, Executive Director  
Revenue Based Finance Coalition

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<sup>10</sup> *Id.*

<sup>11</sup> Cal. Gov't Code Ann. § 11349(a).