

DEPARTMENT OF BUSINESS OVERSIGHT*Ensuring a Fair and Secure Financial Services Marketplace for all Californians***Jan Lynn Owen****Commissioner of Business Oversight**

IN REPLY REFER TO:
FILE NO: PRO 01-18

December 4, 2018

INVITATION FOR COMMENTS ON PROPOSED RULEMAKING
COMMERCIAL FINANCING DISCLOSURES
(PRO 01-18)

BACKGROUND

On September 30, 2018, Governor Brown signed SB 1235 (Chapter 1011, Statutes of 2018). The bill requires a “provider” – a person who extends a specific offer of commercial financing to a recipient – to disclose specified information when the provider extends the offer. The provider must have the recipient sign the disclosures before the provider finalizes the transaction. The disclosures include:

1. The total amount of funds provided;
2. The total dollar cost of financing;
3. The term or estimated term;
4. The method, frequency, and amount of payments;
5. A description of prepayment policies; and,
6. Until January 1, 2024, the total cost of the financing expressed as an annualized rate.

The bill defines commercial financing as including accounts receivable purchase transactions (including factoring), asset-based lending, commercial loans, commercial open-end credit plans, and lease financing intended by the recipient for use primarily for something other than personal, family, or household purposes. The bill includes exemptions from disclosure for some providers and certain types of commercial financing.

Where a provider of factoring and asset-based lending offers a recipient an agreement that describes the general terms and conditions of the commercial financing transactions that will occur under the agreement, the bill allows the provider to draft the disclosures described above using an example transaction.

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The bill requires the Commissioner of Business Oversight (Commissioner) to adopt regulations governing the disclosures described above, including:

1. Definitions, contents, and methods of calculations for each of the disclosures;
2. Requirements concerning the time, manner, and format of the disclosures; and,
3. The appropriate method to express the annualized rate disclosure and types of fees and charges to be included in the calculation, when providers can disclose an estimated annualized rate and the method for calculating such an estimate, and the accuracy requirements and tolerance allowances for the calculation.

The bill does not require providers to comply with the disclosure requirements described above until the Commissioner's final regulations become effective. Finally, the bill empowers the Commissioner to enforce its requirements with respect to any provider licensed under the California Financing Law, commencing with section 22000 of the Financial Code.

INVITATION FOR COMMENTS

The Commissioner seeks input from stakeholders in developing regulations to implement SB 1235. Interested parties may submit comments related to any area under which the Commissioner has authority to adopt rules. In addition, the Commissioner has identified various areas where rulemaking may be appropriate, desirable, or necessary. The Commissioner has formulated topics and questions to assist interested parties in providing input on rulemaking. However, stakeholders are not limited in providing comments to the areas the Commissioner has identified and may comment on any potential area for rulemaking.

POTENTIAL TOPICS FOR RULEMAKING

Definitions

SB 1235 defines terms relating to the commercial financing products that are subject to SB 1235's disclosures and entities that are exempt from making the disclosures. Are additional definitions needed? For the terms already defined, are any definitions unclear; and if so, why? Can the definitions be read to encompass transactions, individuals, or entities not intended to be regulated by the disclosure requirements? Does any definition result in ambiguity regarding whether a transaction, individual, or entity is subject to the disclosure requirements?

Commercial Financing Requiring Estimated Term Disclosures

SB 1235 requires a provider to disclose the "term or estimated term" of the contract. What commercial financing contracts may require an estimated term disclosure, and why? The Commissioner suggests that stakeholders provide sample contracts that may require an estimated term disclosure.

Disclosure of Method, Frequency, and Amount of Payments for Commercial Financing with Flexible or Contingent Repayment Obligations

Some types of commercial financing offer flexible or contingent repayment obligations. The Commissioner suggests that stakeholders provide examples of these types of commercial financing. How should providers disclose to the method, frequency, and amount of payments required under such contracts?

Annualized Rate Disclosure

The version of SB 1235 that was introduced on February 25, 2018 required an annualized rate disclosure as an Annual Percentage Rate (APR) calculated according to provisions of the federal Truth in Lending Act and Regulation Z. A later version required a calculation called Annualized Cost of Capital (ACC). The proposed ACC disclosure would have been calculated as follows:

$$(\text{Total Dollar Cost of Financing} \div \text{Total Amount of Funds Provided}) \times 365 \div (\text{Term or Estimated Term}) \times 100$$

SB 1235, as enacted, requires the Commissioner to select the appropriate method to express the annualized rate disclosure. Should the Commissioner's rules require APR, ACC, or some other annualized rate disclosure? What are the benefits and drawbacks of each annualized rate disclosure? If disclosing an annualized rate may confuse financing applicants, what measures could the Commissioner require to reduce potential confusion for that disclosure?

Types of Commercial Financing

The Commissioner invites stakeholders to provide examples of commercial financing transactions subject to SB 1235 other than fixed-rate, fixed-payment financing. Examples of such transactions may include those with variable interest rates, multiple, flexible or contingent repayment options, merchant cash advances, open-end credit plans, and recourse and non-recourse factoring. What obstacles do stakeholders anticipate in complying with SB 1235 with respect to such transactions, and how can the Commissioner's rules address those obstacles?

Types of Financing Requiring Estimated Annualized Rates

SB 1235 requires the Commissioner to determine when a provider can disclose an estimated annualized rate and how providers must calculate the estimated annualized rate. What types of commercial financing will require estimated annualized rates, and why?

Fees and Charges Included in an Annualized Rate Calculation

What type of fees and charges should be included in an annualized rate calculation? The Commissioner requests comments relating to fees and charges for commercial financing types other than fixed-rate, fixed-payment financing.

Calculating Estimated Terms and Estimated Annualized Rates

How should providers calculate estimated terms and estimated annualized rates for the various commercial financing transactions subject to SB 1235? For example, in a commercial financing transaction with payments set as a percentage of a business's gross receipts, what calculation methodology for estimated term and estimated annualized rate would provide the most helpful disclosure for a business with a recent history of rising gross receipts?

Reliance Upon Internal Underwriting Criteria to Calculate Estimated Terms and Estimated Annualized Rates

For certain products where disclosure of an estimated term and estimated annualized rate may be appropriate, should the calculation methodology established by the Commissioner require that provider to rely upon internal assumptions or calculations the provider used to underwrite the transaction? For example, in a commercial financing transaction with payments set as a percentage of a business's gross receipts, should the estimated term incorporate the provider's internal calculation of the business's future gross receipts that the provider relied upon in underwriting the transaction? Why or why not?

Explanatory and Qualifying Language in Connection with Estimated Terms and Estimated Annualized Rates

What explanatory and qualifying language should providers include when disclosing estimated terms or estimated annualized rates? How can such language minimize potential confusion for the financing applicant and assist the applicant in understanding how the provider calculated the estimate?

Disclosures for Factoring and Asset-Based Lending Transactions with Master Financing Agreements

SB 1235 allows providers of factoring and asset-based lending to provide disclosures based upon an example transaction when the providers use agreements that describe the general terms and conditions of the commercial financing transactions that will occur under the agreements. What rules, if any, should the Commissioner establish to clarify when disclosures based upon example transactions are permitted? What rules, if any, should the Commissioner

establish governing what example (i.e., financing amount) the provider may use when drafting disclosures?

Tolerances

SB 1235 requires the Commissioner's rules to "specify the accuracy requirements and tolerance allowances" for estimated annualized rate calculations. What accuracy requirements and tolerance allowances should the Commissioner establish, and why?

Disclosure Formatting

SB 1235 authorizes the Commissioner to establish rules concerning the formatting of disclosures provided to financing applicants. What, if any, of the information that SB 1235 requires to be disclosed should the disclosure form(s) highlight or prioritize? Should certain disclosures appear at the top of the form(s) in larger or bold font, etc.?

Prepayment Policies

What types of prepayment policies and charges are common for different commercial financing transactions subject to SB 1235? How are these policies and charges characterized to customers today?

TIME FOR COMMENTS

The Commissioner invites interested parties to submit comments by **January 22, 2019**.

WHERE TO SUBMIT COMMENTS

You may submit comments by the following means:

Electronic Mail

Comments may be submitted electronically to regulations@dbo.ca.gov. Include "PRO 01-18" in the subject line with copy to Charles Carriere at charles.carriere@dbo.ca.gov.

U.S. Mail

Department of Business Oversight, Legal Division
Attn: Mark Dyer, Regulations Coordinator
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CONTACT PERSONS

Questions regarding this invitation for comments may be directed to Charles Carriere, Counsel for the Commissioner, at (415) 972-8570.