MANAGENENT COMMITTEE

PRESIDENT
DAVID GRENDE
SIENA LENDING GROUP

FIRST VICE PRESIDENT
JOHN DEPLEDGE
CITIBANK, N.A.

VICE PRESIDENT - FINANCE
JEFFREY GOLDRICH
NORTH MILL CAPITAL LLC

CO-GENERAL COUNSEL
JONATHAN HELFAT
OTTERBOURG P.C.

CO-GENERAL COUNSEL
RICHARD KOHN
GOLDBERG KOHN LTD.

CEO & SECRETARY
RICHARD GUMBRECHT,
SECURED FINANCE NETWORK

Secured Finance Network

September 9, 2019

Via E-Mail: regulations@dbo.ca.gov
charles.carriere@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 Proposed 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 260 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 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.

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.

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, SFNet and its members continue to firmly believe that factoring should be completely excluded from the Disclosure Requirements as it is not a financing product that can be compared to a normal commercial loan and number and type of assumptions necessary to put it into similar terms as other financing products, make the disclosures meaningless and provide information that in no way helps small business in evaluating the cost of factoring against other financing options. Below is a summary of the issues:

1) Row 1 Language. There are two issues to discuss:

    a. This language requires that the provider make assumptions as to the due date of the hypothetical invoice being used to provide the disclosure. Although this is an assumption that needs to be made in order to be able to comply with the Disclosure Requirements, the reality is that almost no customer of a small business pays on the last day of the term of an invoice (the Proposed Regulations refer to the last day of the term as the "due date"). They often pay days or weeks after the due date. We suggest that this row 1 disclosure be modified to allow the provider to either assume payment on the due date or a later date on which payment is expected pursuant to the historical collections information provided by the small business. This would allow the disclosures to be more of a meaningful metric based on actual facts rather than arbitrary assumptions.

    b. The other row 1 assumption is that the invoice is due a set number of days "from the date of assignment." We believe that the more accurate assumption to determine the first date of the period being used to measure APR to be a set number of days "from the date the applicable invoice is created" or simply assume that the date of assumption is the date the invoice is created. Although on the initial date of entering

into the factoring facility, the initial invoices assigned may be in the middle of the term of the invoice, factoring facilities are usually an ongoing facility under which the provider takes assignment of future invoices as they are created. Therefore, assuming invoices are assigned as they are created would provide better information for the small business.

2) Row 3 Disclosures - APR. Similar to the comments above, it would be more accurate for the disclosures to allow an assumption that the payment will be received on a date determined based on available historical collections information rather than arbitrarily picking the due date.

3) Row 4 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.

4) Row 6 Disclosure – Estimated Term. Again, consistent with the above, we suggest that the provider be allowed to determine the estimated term based on the historical collections information to the extent such information is available. This assumption would make the disclosure more meaningful and in line with reality.

5) Row 7 Disclosure – Prepayment. Prepayment is not a concept that comes up in factoring arrangements. Small businesses generally don't have the liquidity to "repurchase" an assigned invoice and are not looking to have the provider assign invoices back to them. As such, we strongly urge that this row simply be deleted. Its inclusion creates confusion for small businesses as it introduces a concept that does not apply.

ASSET BASED LENDING

1) Row 1 Assumptions. The Proposed Regulations suggest that the provider make the assumptions based on a hypothetical advance and that no other advances will be made during the life of the facility. This is not in-line with reality. 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. 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. 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) Row 4 Disclosures. Similar to the comments above to the factoring disclosures, there are a number of fees 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 the first month's outstanding balance would significantly skew the APR calculation. Similar to the above, we suggest that these fees and expenses be allowed to be annualized.

3) Row 7 Disclosures. Asset-based transactions generally have a given term similar to other open-ended financing facilities. The assumption that the facility will be paid over a certain period of time based on a daily collection amount is not accurate.

TREATMENT OF DEPOSITORY INSTITUTION AFFILIATES:

Section 2057(a)(9) of the Proposed Regulations defines depository institutions to exclude any non-depository subsidiaries or affiliates. This language is confusing since if the subsidiaries and affiliates are depository institutions, they would be included as a depository institution in this definition without the need for additional language. Therefore, the exclusion only confuses the financial institutions trying to comply with the Disclosure Requirements. Additionally, affiliates and subsidiaries of depository institutions are generally not depository institutions themselves. SFNet and its members strongly believe that depository institutions should be defined to include those affiliates and subsidiaries which are regulated by applicable federal or state banking supervisors and agencies and subject to regulatory oversight, whether or not they are depository institutions. These entities are highly regulated with regulation on par with that of their affiliated depository institutions.

GENERAL COMMENTS TO DEFINITIONS IN SECTION 2057(A) OF THE PROPOSED REGULATIONS:

1) Clause (i) of the definition of "Asset-based lending transaction" should be modified to make it clear that payments may also be collected by the recipient and deposited into a designated account. We suggest the following:

> "Forwarding payments" includes arrangements in which a recipient and the finance company create an account in which third party obligors make payments, ~~and~~ arrangements in which the recipient directs third party obligors to make payments to the finance company and arrangements in which the recipient and finance company create a bank account into which a recipient deposits payments received from third party obligors.

2) The definition of "Benchmark Rate" should be modified as follows to show that the prime rate is also a generally used rate:

> "Benchmark rate" means a publicly available rate index, such as the London Interbank Offered Rate (LIBOR) (or a successor benchmark rate) and/or prime rate of interest, commonly used to calculate the interest rate in adjustable rate transactions in the credit industry.

3) The definition of "Sales-based financing" can be read broadly to include factoring or asset-based lending. We suggest adding language to this definition to specifically exclude Asset-based lending transactions and factoring transactions using the carefully crafted definitions of asset-based lending and factoring appearing in the Proposed Regulations.

4) The proposed Regulations as they apply to factoring and asset-based transactions generally refer to payment received from the customers of the recipient. We suggest using the defined term "Account Debtor" as set forth under 9102(3) of the California Commercial Code.

THRESHOLDS FOR DISCLOSURE

The distinction between "approved credit limit" and "maximum advance limit" as it relates to factoring and asset-based transactions is very confusing. Under an open-ended asset-based transaction, there will be a maximum advance limit which may not be exceeded at any time. However, the aggregate amount of advances made during the life of the facility may exceed this limit as they are advanced and repaid. For example, a facility with a $100,000 limit may have the full $100,000 advanced and repaid monthly over a 12-month period such that during the life of the facility $1,200,000 will have been advanced and repaid. As we have discussed, in the above example the $100,000 credit limit is what is to be used to determine whether compliance with the Disclosure Requirements is necessary. The use of "maximum advance limit" and "approved credit limit" in Section 2071 of the Proposed Regulations are very confusing and make it difficult for providers to know whether they need to comply with the Disclosure Requirements. We suggest that the language be simplified with respect to open-ended transactions so that the "maximum credit limit" (the amount which can't be exceeded at any one time) be the determining factor.

Similarly, a factoring arrangement may be structured in a manner similar to an open-ended credit facility so that invoices may be purchased over a set period of time up to a maximum amount measured at any given time. However, the aggregate amount of invoices purchased over the life of the facility may far exceed that maximum amount. Again, the maximum amount is what should be the determining factor. In factoring arrangements, we suggest the term "approved advance limit" is used with the term "approved advance limit" set forth in Section 2057(a) of the Proposed Regulation rewritten as follows:

> "Approved advance limit" means the maximum amount a recipient can receive under a factoring facility on an aggregate basis, whether based solely on factored accounts receivable or based on factored accounts receivable and a percentage of value of some or all of certain other assets of the recipient, including inventory, intellectual property, marketable securities or letters of credit.

Additionally, there are factoring transactions that are "non-borrowing", meaning that the factor does not advance funds against factored receivables. 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.

DISCLOSURES FOR FINANCING AMENDMENTS

Although the compliance with the Disclosure Requirements can be beneficial at the commencement of the financing arrangement and at the time when the arrangement is being amended, there are circumstances when a financing arrangement is being amended and additional disclosures only confuse the small business. As such, in Section 2057(a)(4)(ii), the definition of "at the time of extending a specific offer of commercial financing" should be modified so that it is clear that no

disclosure is required if: (1) the amendment or supplement to the existing commercial financing contract reduces the finance charge or APR or (2) the amendment or supplement to the existing commercial financing does not change the current finance charge or APR.

Sincerely,

Richard D. Gumbrecht
CEO
Secured Finance Network

T 212.792.9390 F 212.564.6053 SFNET.COM
370 7TH AVENUE, SUITE 1801, NEW YORK, NY