



Commercial Finance Association

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Via E-Mail: [regulations@dbo.ca.gov](mailto:regulations@dbo.ca.gov)  
[charles.carriere@dbo.ca.gov](mailto:charles.carriere@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.

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## **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 Policies: 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,

A handwritten signature in black ink, appearing to read "R. Gumbrecht", with a horizontal line extending to the right.

Richard Gumbrecht, CEO  
COMMERCIAL FINANCE ASSOCIATION