

April 6, 2018

Senator Steve Glazer  
State Capitol  
Room 4072  
Sacramento, CA 95814

**RE: Comments Regarding SB 1235 (Commercial Financing Disclosure)**

Dear Senator Glazer:

On behalf of the Electronic Transactions Association (“ETA”), we appreciate the opportunity to share our thoughts regarding SB 1235. ETA supports transparency in small business financing disclosures, including providing borrowers with the best information to compare costs and make informed decisions. The competitive marketplace for small business lending dictates that transparency be front of mind for all parties in the relationship. ETA believes that this is best left to the competitive marketplace, however, if you believe that legislation is necessary in this space, we have a few thoughts on how that legislation should be modeled.

ETA is the leading trade association for the payments industry, representing over 500 companies that offer electronic transaction processing products and services, including financial institutions, transaction processors, payments networks, and others. ETA also has members that are engaged in online lending for commercial enterprises, primarily small businesses, either directly or in partnership with other lenders.

**Principles**

Here are commercial loan disclosure principles that we believe could provide small business finance companies a uniform set of principles to guide transparency and disclosure.

*(a) Any entity making a commercial loan shall provide to the borrower a written statement showing in clear and conspicuous terms all of the following, as applicable, with respect to that commercial loan:*

*(1) Commercial Loan Costs.*

*(A) For a commercial loan not under an open-end credit program, as defined in Section 22650, commercial loan costs shall include, as applicable, the total dollar costs to be charged to a borrower, assuming the borrower pays the commercial loan according to its original payment schedule, plus all required fees and charges that cannot be avoided by the borrower.*

*(B) For a commercial loan under an open-end credit program, as defined in Section 22650, commercial loan costs shall include, as applicable, the total interest to be charged to a borrower, based on the amount scheduled to be drawn by borrower at the time of disclosure, or if no initial draw is scheduled then the maximum draw amount of credit available under the open-end credit program, in each case assuming the borrower repays the commercial loan according to its original payment schedule, plus all required periodic and non-periodic fees and charges that cannot be avoided by a borrower.*

*(2) Commercial Loan Amount.*

*(A) For a commercial loan not under an open-end credit program, as defined in Section 22650, the principal loan amount of the commercial loan and, if different from the principal loan amount, the total amount disbursed to the borrower or at the borrower's direction, as applicable, after deducting any fees and charges that will be withheld from loan proceeds.*

*(B) For a commercial loan under an open-end credit program, as defined in Section 22650, the maximum amount of credit available for draw by the borrower under the open-end credit program and, if applicable, the amount scheduled to be drawn by the borrower at the time of disclosure.*

*(3) A description of the terms of repayment, including for a commercial loan not under an open-end credit program, the amount, number and frequency of any scheduled payments, as applicable.*

*(4) If applicable, the fact that a licensee has acquired or will acquire a security interest in collateral and a description of the collateral.*

*(5) A description of any other fees in connection with the commercial loan that can be avoided by a borrower, including late payment fees and returned payment fees.*

*(b) The statement required by this section shall be provided to the borrower prior to execution of the commercial loan agreement, either as a separate disclosure or as part of the commercial loan agreement.*

**Specific Recommendations**

In addition to the principles above, here are some more specific recommendations based on the latest draft of the legislation.

**APR Disclosure**

22802(b)(4) – We believe that this section on APR should be deleted. If an APR disclosure was required for commercial loans, such a disclosure has the potential to be even more confusing and less useful for small businesses for many reasons, including the following:

- a. Mandating the calculation of APR under TILA in a commercial setting would result in different calculations depending on the product, even if the overall repayment amount is the same. For example, TILA does not contemplate daily pay loans. How would weekend and bank holidays be addressed? Some lenders skip those days and others require make up payments. If lenders address these issues differently, it will result in different APRs for the exact same product, even when the total dollar cost of credit is the same. There is no benefit to a small business by imposing an APR disclosure on a product that was never contemplated to be covered by TILA and that would result in misleading APRs.
- b. The Bill does not specify exactly how the APR should be disclosed. TILA specifically mandates that the APR disclosure be accurate with 1/8 of 1 percentage point. 12 C.F.R. 1026.22(a)(2). This requires the APR to be disclosed at least to one decimal point in many circumstances.
- c. The Bill does not address any tolerance limits for APR calculation errors. As mentioned in paragraph b above, TILA has specific rules for APR calculation errors and provides a threshold in which an APR is deemed accurate. However, an APR that falls above that threshold is a violation of TILA.
- d. Under TILA, an APR cannot be calculated without a determination as to what types of fees and charges are Finance Charges (a defined term under TILA). Finance charges are included in the APR calculation. Therefore, in order to calculate APR there must be clear guidance on what is or is not a Finance Charge. The proposed Bill does not state what fees should be considered Finance Charges.
- e. APR calculations are highly duration-sensitive for loan terms of less than a year. In other words, the APR increases rapidly the shorter the loan term. For example, the APR of typical short-term commercial loans will fluctuate widely based on only small differences in the term of the loans.
- f. TCC is more useful for comparing the absolute cost of a loan with a small business's expected return from investing the loan proceeds. A business that expects a short-term return on its investment would likely choose a loan with a shorter term and higher monthly payments to minimize TCC, even though that loan is likely to have a higher APR.
- g. Similarly, certain commercial finance products, such as Merchant Cash Advances ("MCAs"), have a fixed cost but no fixed term and are paid through a set percentage of the small business' future receivables or sales. Solely focusing on the effective APR of such transactions would not tell the whole story because, if the business has higher sales than expected and delivers the purchased receivables faster than anticipated, the duration of the transaction decreases and the effective APR increases.

The clearest cost disclosure is the dollar cost of credit or total cost of capital, which is what matters to small business owners, and what the industry should be providing across all products. Total cost is readily calculable and provides the clearest basis for comparison among commercial finance options, no matter how they are denominated (loan, MCA, factoring, equipment lease).

#### Timing of Disclosure

22802(a) - The timing of the disclosures should be at or prior to the consummation of the commercial financing.

\* \* \*

Thank you for the opportunity to participate in the discussion on this important issue. If you have any additional questions, you can contact me or ETA Senior Vice President, Scott Talbott at [stalbott@electran.org](mailto:stalbott@electran.org).

Sincerely,



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