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February 14, 2023

The Honorable Melony Griffith
Chair, Finance Committee
Maryland Senate
3 East, Miller Senate Office Building
Annapolis, Maryland 21401

RE: Opposition to S.B. 496

Chair Griffith, Vice Chair Klausmeier, and Distinguished Members of the Senate Finance Committee,

On behalf of the Electronic Transactions Association ("ETA"), the leading trade association representing the payments industry, I appreciate the opportunity to share our broad concerns with S.B. 496.

ETA supports disclosures that promote transparency and accountability for small business borrowers. However, as drafted, S.B. 496 could be confusing for both online small business lenders and the small business community. Moreover, ETA is concerned that the legislation's effective date will not provide regulators with the necessary time to promulgate rules required by the legislation and will not give providers of commercial financing enough time to comply.

Small businesses are the backbone of the economy and have different needs and objectives than consumers. These businesses often rely on financing to buy inventory, smooth cash flow, expand their marketing, and the ability to obtain financing that enables them to continue to grow. Small business lenders have developed credit products specifically designed to meet those needs and objectives. ETA supports maintaining choice in small business financing, thus allowing these businesses to select, among multiple available options, the best product that suits their needs to secure the capital they need to be successful. S.B. 496, would impose burdensome barriers for providers of commercial financing, and likely result in less options for the very businesses the legislation aims to protect. Reducing options for small businesses in need of capital will hurt, not benefit, these same small businesses. Therefore, ETA would like to work with the committee to incorporate changes to the current bill and oppose S.B. 496 as currently drafted.

Specifically, ETA's concerns with S.B. 496 include:

- **Effective Date**
  - As a threshold matter, S.B. 496 would adopt an effective date of October 1, 2023, which would place an undue regulatory compliance burden on an industry devoting all available resources to sustaining small businesses through uncertain inflationary economic related financial struggles. Given the substantial length of time it took the states of California and New York to adopt regulations, let alone implement them, the short time frame provided by this legislation does not seem adequate. Instead, the legislation should allow for a longer regulatory comment and approval process such as a 180 day compliance period, which will afford providers sufficient time thereafter to make the complex systemic and operational changes required for compliance with new regulations and disclosures of this complex and de novo nature.
- **Definitions**
  - The legislation references numerous phrases and terms, such as "interest accrued," without defining what these terms mean. Clarifications and precise definitions are necessary to provide

certainty of the bill's requirements and to help ensure the ability to provide accurate and meaningful disclosures in compliance with the law.

- The definition of "provider" should exclude "1st party financing;" specifically, where the owner of the product or service is the one offering the financing opportunity.

- The definition of "recipient" should be limited to persons with a principal place of business in Maryland. In order to determine the recipient's principal place of business, providers should be permitted to rely on either (1) a representation from the recipient, or (2) the business address provided by the recipient.

- The legislation defines "total repayment amount" as the "disbursement amount of a sales-based financing transaction plus the finance charge". This definition needs to be refined to address situations where the "total repayment amount" and the "disbursement amount" are not the same, for example, where a provider is paying off a third-party on behalf of the recipient. One example of where the definitions do not take into account all scenarios that actually occur:

    - A provider provides a recipient with a $20,000 loan with a finance charge of $2,000. However, the provider has to pay off a third-party $3,000, which means that the recipient is going to receive a disbursement of $17,000. The disbursement of $17,000 plus the finance charge of $2,000 equals $19,000, not the actual total repayment amount of $22,000.

- **Annualized Percentage Rate**

    - ETA is concerned that S.B. 496, by mandating an annual percentage rate or estimated annual percentage rate (collectively "APR") disclosure for commercial financing, will create significant confusion and uncertainty for Maryland small businesses trying to make informed decisions about the cost of financing products. The Truth in Lending Act ("TILA") was enacted strictly for consumer transactions, not commercial transactions and does not take into account the unique payment features of sales-based financing products, which do not have a fixed term, fixed payments, or have an absolute right to repay.

    - Even the Consumer Financial Protection Bureau in its recent soon to be finalized regulations for Sec. 1071 of Dodd-Frank stated that because these types of products do not have a defined term or a periodic payment amount, it would require a funding company to assume or estimate parts of the APR formula, which only increases complexity. This is not a simple calculation and funding companies have to make a lot of assumptions in order to provide a small business with an estimated APR, which in turn could lead to misleading disclosures, even if that was not the intention of the funding company.

    - On or about December 7, 2022, the Consumer Financial Protection Bureau ("CFPB") issued a Notice of Intent to Make a Preemption Determination under the Truth in Lending Act (Regulation Z) regarding the New York commercial disclosure law ("New York Disclosure"), which requires an APR disclosure. S.B. 496 is modeled on the New York Disclosure. As of today, February 14, 2023, the CFPB has not issued its final ruling on the preemption determination. It does not make

sense for S.B. 496 to proceed at this time because the APR disclosure requirement could be preempted by federal law. If parts of the New York Disclosure, which S.B. 496 is based on, are preempted, then S.B. 496 would also be preempted. It would make more sense to wait until the outcome of the CFPB's preemption determination before proceeding.

- On December 2, 2022, a non-profit group filed a lawsuit in California seeking to stop the California Department of Financial Protection and Innovation ("DFPI") from enforcing its commercial financing disclosure regulations ("California Regulations") because the regulations violate the First Amendment rights of its members and because the California Regulations require the disclosure of a finance charge and APR, which are preempted under federal law (the CFPB may also take into account the preemption issue of the California Regulations in the above preemption determination). The First Amendment argument alleges that the non-profit group members are compelled by the California Regulations to provide inaccurate and misleading disclosures and costs of the commercial financing products. The same type of First Amendment claims could be made for S.B. 496 as it compels similar inaccurate and misleading disclosures to be made. Because this case has not been litigated yet and could have a direct impact on S.B. 496, it does not make sense to proceed at this time and wait for the outcome of the litigation.

- As an alternative to APR, ETA urges the committee to consider Total Cost of Capital ("TCC") as the method for disclosing the cost of financing products, which is what matters to small business owners. TCC captures all interest and fees (for certain products that do not charge interest, but rather a fixed fee for capital) that are a condition of receiving capital. TCC is readily calculable and provides the clearest, most accurate basis for comparison among commercial finance options, no matter how they are denominated.

- **Calculation of APR for Daily Payment Products**
  - The bill states that APR should be calculated in accordance with the TILA. This legislation does not provide the necessary information to calculate APR for a daily payment product. Each month has a different number of days in which payments are collected and providers need to know how many payment days (not calendar days) to assume exist in every month. Simply assuming that payments can be made every calendar day is misleading because it's impossible to make a payment every day and this would assume more payments than actually can be made, thereby artificially inflating the APR, and leading to a misleading disclosure for daily payment products.

- **Sales-Based Financing APR Reporting**
  - S.B. 496 requires providers of sales-based financing to report to the Commissioner each year (1) the estimated APR rates given to each recipient, and (2) the actual APR rates of each completed sales-based financing transaction. This reporting requirement would be extremely onerous and runs counter to Maryland's intent to adopt regulations substantially similar to those adopted by the New York Department of Financial Services. Under the New York regulations, this report is required only if a provider chooses the opt-in method whereas S.B. 496 would require all providers, regardless of the method they choose, to file an annual report. ETA would request that this reporting requirement either be eliminated or only apply to the opt-in method.

- Moreover, the reporting requirement in S.B. 496 would require the provider to recalculate the APR of each sales-based financing at the time the recipient pays off the balance. ETA does not understand how this type of calculation will be beneficial to anyone. Moreover, the lack of precise definitions for this requirement would have it apply across multiple scenarios. For example, if a recipient decides to pay off a sales-based financing early for any reason, such as the recipient's desire to obtain a new financing product or a sudden increase in the recipient's cash flow, the actual APR will vary (possibly significantly) from the original estimated APR. Additionally, if the sales-based financing were to become charged off or subject to a workout arrangement, the actual APR will vary (possibly significantly) from the original estimated APR. ETA is unclear as to how this requirement would result in producing meaningful data. ETA strongly opposes this requirement and any similar requirement, which could result in a false appearance that a provider is significantly underestimating the APR.

➢ **Disclosure of the Amount of Average Projected Payments Per Month (for periodic payments that are not monthly)**

- The requirement of a monthly payment amount disclosure for products that do not have a monthly payment is problematic for two reasons: (1) it is confusing to the small business; and (2) it expresses a preference for products that ultimately may be more expensive. Requiring disclosure of the actual frequency and amount of payments makes sense and is helpful to the small business. Requiring disclosure of a hypothetical frequency and amount is potentially harmful because of the confusion it could create. Small businesses may not understand why they are receiving a disclosure of a hypothetical monthly payment, and instead assume that they can pay monthly when, in fact, the financing contract requires payments of a different frequency. Adding such confusion is contrary to the purpose of the bill, which is to provide clear and transparent disclosures.

- Requiring disclosure of an average monthly cost for payments that are not monthly expresses a preference for products with monthly payments because products with monthly payments will have a lower average monthly cost than products with daily or weekly payments, as monthly payment products typically have longer terms. This ignores the reality that products with monthly payments may have a higher overall total cost due to the fact that the small business is paying interest over a longer term. Thus, a critical consideration is the overall total cost of a product as well as the periodic payment. More importantly, the disclosure seems likely to cause confusion given that the information would conflict with the written terms of the commercial financing agreement. The average monthly cost of a product is not relevant if it does not reflect the actual payments a small business is required to make, or even the actual monthly cost, given that daily, weekly, and bi-weekly payment frequencies all will have different monthly costs and different averages.

➢ **TILA Disclosure Exemption**

- The New York Disclosure provides that the definition of "commercial financing" **(b) does not include any transaction in which a financier provides a disclosure required by the Truth in Lending Act, 15 U.S.C. § 1601 et seq., that is compliant with such Act**. This provision prevents unnecessary duplication of disclosures from providers who already provide TILA compliant disclosures in commercial financing transactions and encourages uniformity across the country

rather than requiring different disclosures in each state, dependent on the specific requirements of a CFDL.

- **Renewal Financing**
  - S.B. 496 requires disclosures for renewal financing that will likely cause confusion. While we are not opposed to disclosing how much of any new financing is being used to pay off existing financing from the same provider, we think it should be a clear, succinct notice or a simple disclosure. The amount of disclosures and explanations required of financing providers is already voluminous and, with additional language and disclosures, will confuse the recipient and increase the likelihood that the recipient might not even read any of the disclosures.
  - The legislation requires providers of renewal financing transactions to disclose any "double dipping" as described in the legislation. First, double dipping is not a formal term and is not widely used throughout industry. Second, the term, as defined, fails to consider how renewal financing works in practice. For example, at the time the disclosure is given, the balance on the existing financing will most likely change prior to consummation of the new financing agreement. Therefore, the amount of the new financing that is used to pay off prior financing could be less if additional payments on the prior financing are made or could be more if a recipient misses a payment. Therefore, ETA suggests replacing the "double dipping" question with a statement that "part of your renewal financing will be used to pay-off your current financing with [name of provider]."

- **Other State Commercial Financing Disclosure Laws**
  - California and New York have passed commercial financing disclosure laws, however, the implementation of their laws took substantial time because of the complexity of the issues. California held eight rounds of comments on proposed regulations and New York made three similar requests, even though they borrowed from much of the work already completed by California. Maryland should also take deliberate and thoughtful time to determine the right law and regulations that would provide the most effective disclosures without overburdening Maryland small business owners.
    - **Timing of Signatures**. For example, a burdensome signature requirement stands out, S.B. 496 requires a recipient to sign the required disclosures "before a provider may allow the recipient to proceed with the commercial financing application" whereas the NY commercial financing disclosure law requires the recipient to sign "prior to consummating a commercial financing". ETA is unclear what Maryland's version of this provision means. It could mean that the recipient must sign the disclosures prior to accepting the offer, in the middle of the application process, prior to funding or some other point in time. Additionally, if a recipient is given multiple pricing options, the recipient should only be required to sign disclosures for the pricing option that the recipient accepts. Ideally, a recipient will be required to sign the disclosure "prior to consummating a commercial financing" as is required by the New York Disclosure. That way, the recipient will be able to sign the disclosures simultaneously with any other documentation and the standards for NY and MD will be consistent.

Given how the uncertain inflationary economy continues to threaten the survival of many Maryland small businesses, now is not the time to pass legislation that would threaten their commercial financing options by creating burdensome and confusing barriers for small business lending providers. S.B. 496 needs more thoughtful deliberation and industry input to create a clear, fair, and uniform regulatory structure. Therefore, ETA urges the committee to reject S.B. 496 in its current form and welcomes the opportunity to work with the sponsor and proponents of the legislation during the interim to develop a legislative proposal that all parties can support.

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.

Respectfully Submitted,

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