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subject: PRO 01-18

ApplePie Capital, Inc. (together with its subsidiaries, "ApplePie Capital") specializes in making financing solutions available to franchise businesses. We provide franchisees with access to SBA, conventional, and equipment loans by either placing loans with third party lenders via our wholly-owned subsidiary broker or arranging ApplePie Capital-branded loans to borrowers through our bank partner. ApplePie Capital does not directly extend credit to borrowers through its balance sheet.

ApplePie Capital-branded loans are fixed rate, term loans with a minimum loan size of $100K and are used exclusively for new builds, purchases, refinance of, and recapitalization of franchise businesses. The product has an origination fee of 0-4.99%, and some loans are subject to prepayment fees. Prepayment fees may be equal to 1% for the entire length of the loan, or may be structured according to a declining scale in which a fee of 3% or 4% is levied on any amounts prepaid in year one and which decrease 1% each following year the loan matures until the prepayment fees equal 0%. Before any ApplePie Capital-branded loan product is funded, ApplePie Capital delivers a "loan terms addendum" to the borrower detailing the key terms of the loan. The loan terms addendum is part of the binding loan agreement for each loan and is required to be signed by the borrower (together with other usual and customary loan documents) prior to funding the loan. The loan terms addendum includes, but is not limited to, the following information required to be disclosed under SB 1235: the amount disbursed to the borrower, the interest rate, the origination fee (if applicable), the prepayment fee (if applicable), and a payment schedule identifying the amount of every payment due during the term of the loan.

POTENTIAL TOPIC 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?

Comment 1

1.1 "At The Time of Extending A Specific Commercial Financing Offer"
SB1235 states, "A provider subject to this division shall disclose all the information in subdivision (b) or in Section 22803, if applicable, at the time of extending a specific commercial financing offer to that recipient…." The underlined statement could result in ambiguity as to when the requirement to disclose becomes effective.

One reading of this statement is that the requirement to disclose "at the time of extending" occurs at any single point in time during the timeframe 1) before consummation of a commercial financing transaction with a specific recipient but 2) after advertisement of offers available generally to prospective recipients. We assume that the law intends at least the actual terms offered in the agreement to be disclosed, and this definition allows the provider to identify the appropriate time before consummation when the offer reflects the final terms in the commercial financing agreement. For context, the development of offers for ApplePie Capital-branded loans is contingent on multi-stage underwriting and some tradeoffs/choices by the potential borrower throughout the process. During the underwriting process for ApplePie Capital-branded loan (i.e. before terms are finalized in the "loan terms addendum" referenced above), ApplePie Capital may provide borrowers with one or more written communications, which are designed to help borrowers understand their possible financing options, even though the terms are estimates (sometimes ranges) and subject to further underwriting, changing conditions, and additional action on the part of the borrower (e.g. identification of a location for the business, finalization of project funding needs, acquisition of life insurance for key operators, etc.). As an analogy, under Regulation Z, disclosures are only required to be provided once, 'before consummation' of the loan (except for certain types of consumer financing transactions which are designated in the regulation as having 'special timing requirements' and triggers for disclosure.)

If the underlined statement from SB1235 quoted above is intended to define a specific triggering event which identifies one or more points in time in which an offer is made and the requirement to disclose is created before finalization of terms, a definition for "specific" as it relates to the triggering event for a "specific commercial financing offer" will need to be created, as well as requirements for updating those disclosures should a subsequent triggering event occur during the process of developing the offer. Depending on the degree to which such a definition would cover all commercial financing transactions or only some types of commercial financing transactions, additional instructions may need to be created to handle assumptions, estimates, and ranges, which may not be inherent in the final terms, but exist simply due to the definition of a triggering event which would occur in advance of finalization of terms.

We believe that a single, specific event, reflecting finalization of terms, in a single point in time should be clearly defined to ensure a standardized disclosure approach among all market participants, or at least among all market participants in similar categories of commercial financing transactions. A clear, unambiguous definition will promote the goals of this legislation by ensuring that all borrowers receive the same disclosure at the same time, instead of receiving multiple, potentially conflicting disclosures (given that loan terms may change up until

the time the loan is funded) at different points in the underwriting process.

1.2 "Recipient"

"Recipient" means a person who is presented a specific commercial financing offer by a provider that is equal to or less than five hundred thousand dollars ($500,000).

- ***"Financing offer of equal to or less than five hundred thousand dollars ($500,000)"***
  "Financing offer of equal to or less than five hundred thousand dollars ($500,000)" is ambiguous because it does not specify whether the $500,000 threshold refers to the initial principal balance of the loan or some other amount (such as the net proceeds to borrower or total of all payments)
- ***"Person who is presented a specific commercial financing offer"***
  Organizations: The phrase "person who is presented a specific commercial financing offer" is ambiguous in the context of commercial financing transactions. In the commercial financing context, "persons" may take many forms (individuals, partnerships, corporations, limited liability companies, etc.), and it makes sense for the signature to be obtained from an authorized signer of the liable party, not just the individual who may represent the "recipient" (as defined in the rule) in receiving disclosures. Accordingly, we would recommend clarifying that it is acceptable for market participants to rely on a representation from the authorized signer that he/she has the authority to sign the disclosures on behalf of the "recipient" (as defined in the rule). At ApplePie Capital, we do verify signing the authority of each individual before funding of each loan, but it is unlikely that verification of signing authority (beyond the signer's representation) happens for many smaller dollar transactions.
  Multiple parties: It is possible for multiple parties to be presented and/or liable for the same commercial financing transaction. It would make sense to clarify which party or parties meet the definition of "recipient" for the purpose of disclosure and obtaining signature. There may be multiple parties receiving funds or primarily liable for the financing transaction and/or parties who provide surety or guaranty in the event the primary recipient(s) cannot meet the obligations of the commercial financing transaction. For example, ApplePie Capital arranges term loans to a business entity that receives funds and is primarily liable; at the same time, ApplePie Capital also receives guaranties from the owners of the entity and any other individuals that offer such a guaranty to strengthen the credit profile of the borrowing entity and its project.
- **California nexus**
  If the law and regulation intends for "recipient" to address California recipients, the definition of what factor(s) constitute a California recipient is currently ambiguous (e.g., state of registration, principal place of business, physical address, or other nexus or non-nexus with California, to be defined by this regulation). Similar to signing authority, we believe providers should be permitted to rely on the borrower's representation to determine if the person is a California recipient. Some providers are already subject to federal requirements for customer identification include identifying the physical address for a customer's principal place of business. Additional requirements for providers to determine California nexus beyond the customer's representation could require onerous new collection and could result in providers choosing to make disclosures and obtain

signatures outside California out of an abundance of caution.

1.3 "Provider"
SB 1235 defines "Provider" as "a person who extends a specific offer of commercial financing to a recipient." SB1235's definition of "Provider" also includes a nondepository institution, which enters into a written agreement with a depository institution to arrange for the extension of commercial financing by the depository institution to a recipient via an online lending platform administered by the nondepository institution.

A distinction should be made between nondepository institutions that 1) enter into written agreements that include the specific terms for an extension of credit and 2) simply enter into written agreements to refer loans to third party lenders (i.e. brokering/packaging), without arranging any terms or the extension of credit. Nondepository institutions that simply facilitate the referral of loan packages through their online platform may not have the ability to make the necessary disclosures since the terms and extension of credit are arranged by the depository institution making the loan, and the nondepository broker may only know whether the loan was approved and for what amount after the loan is consummated.

POTENTIAL TOPIC FOR RULEMAKING:

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?

Comment 2

For the required annualized rate calculation, it would be reasonable to see a tolerance of 25 basis points above or below the rate as defined by DBO. For the required amount financed calculation, it would make sense for a tolerance of the maximum of of $5 or 1% of the amount financed calculation as defined by DBO.

Regulation Z provides some categories that would be useful to consider in outlining tolerances:

- Good faith reliance on faulty calculation tools, subject to responsibility to verify accuracy, to use properly, and to provide appropriate input data.
- Specifically for the rate, Regulation Z provides a tolerance between ¼ of 1% and ⅛ of 1% depending on the regularity of draws, payments, and other factors in the transaction.
- For the "finance charge", Regulation Z provides two types of tolerances.
    - For mortgage loans which tend to be large and long in duration, any overstatement of the charges and up to $100 in understatement is tolerated.
    - For smaller loans (Regulation Z applies to loans $50K or less), the tolerance is $5 above and below if the amount financed is $1000 or less and $10 above and below if the amount financed is greater than $1000 up to $50,000.

POTENTIAL TOPIC FOR RULEMAKING:

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?

Comment 3

For the ApplePie Capital-branded loan product, certain loans may be subject to a prepayment fee. The prepayment fee policy for the ApplePie Capital-branded loan product is either 1% for the life of the loan or up to 4% of any optional prepayment during the 1st year of the loan declining by 1% each year of the loan until the fee for optional prepayment is 0%. If a prepayment fee is applicable to any given loan, it is clearly described in the applicable written communications and the final loan agreement.

POTENTIAL ADDITIONAL TOPIC(S) FOR RULEMAKING:

Comment 4

Due to certain types of charges outside the control of the provider, rule-making should consider permitting variations (or establishing tolerance thresholds) between certain actual amounts and the amounts that are disclosed to and agreed to by the borrower, especially the amount of funds to be disbursed and the dollar cost of financing. For purchase transactions, the amounts disbursed to borrowers will vary based on the day of closing due to factors outside the control of the provider, such as property tax allocation, insurance payments, and escrow allocation. In cases where the borrower finances the purchase of an existing franchise business through an ApplePie Capital-branded loan, the exact amount of funds to be disbursed is estimated at the time the loan is consummated, and the escrow agent for the purchase transaction provides the final amount to be disbursed just before funds are released (but after the loan agreement and loan terms addendum have been signed).