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January 22, 2019

VIA ELECTRONIC MAIL

Department of Business Oversight, Legal Division
Attn: Mark Dyer, Regulations Coordinator
1515 K Street, Suite 200
Sacramento, California 95814-4052
regulations@dbo.ca.gov

RE: *Response to Invitation for Comments on Proposed Rulemaking Commercial Financing Disclosures (PRO 01-18)*

Dear Mr. Dyer:

This law office, in consultation with another firm representing multiple factoring companies in the industry ("Factors"), are submitting this response to the Department of Business Oversight's Invitation for Comments on Proposed Rulemaking in Commercial Financing Disclosures to provide additional detailed information regarding the potential impact of SB1235 on Factors.

Factors enter agreements with companies to purchase existing accounts receivable and purchase orders, effectively allowing companies to receive payments on their accounts receivable and purchase orders before their due dates. Factors finance customers on an ongoing basis similar to a bank's line of credit where money continues to flow in and out depending on the needs of the customer.

Most Factors enter one master general agreement with their customers to purchase eligible receivables over the life of the agreement, which sometimes has a set term. Over the contract's life, individual transactions take place pursuant to the terms of the master general agreement as the customer presents eligible receivables to the factoring company for purchase, and the Factors determines them to be eligible for purchase. This can happen as often as daily, weekly, monthly, or whenever the customer wants. Many Factors require customers to maintain reserve accounts with the Factor, from which payments due to the Factor may be made under specified circumstances.

With this background in mind, we provide the following comments in response to the questions raised by the Department of Business Oversight:

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?

Yes, there is ambiguity, but new definitions can solve the ambiguity.

Section 2800(n) of the law provides, "(n) '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)." The law defines "commercial financing" to include factoring. However, the law is unclear what a "specific commercial financing offer" means in the context of factoring, where an offer is made at the outset to purchase eligible accounts receivable over a specified term, and the customer presents eligible accounts receivable at numerous various times over the term for purchase.

In order to clarify this issue, we propose the following additional definitions:

- "Specific Commercial Financing Offer" means the aggregate of all potential Commercial Financing transactions offered pursuant to a general agreement to purchase Eligible Accounts Receivable and Eligible Purchase Orders during the initial contractual credit term, which is agreed upon in writing by the parties to the agreement as the amount that is reasonably foreseeable to be offered over the course of the relationship of the parties.

- "Eligible Accounts Receivable" means accounts receivable which actually exist when funding occurs.

- "Eligible Purchase Orders" means purchase orders which actually exist when funding occurs.

These definitions provide clarity that the cumulative amount of potential financing offered pursuant to a general agreement to purchase Eligible Accounts Receivable and Eligible Purchase Orders shall be used to calculate whether a specific commercial financing offer is equal to or less than five hundred thousand dollars ($500,000), even if accounts receivable and purchase orders totaling that amount are not ultimately purchased, subject to the cumulative amount reflecting an amount that the parties agree in writing is reasonably foreseeable over the course of the relationship of the provider and recipient. In other words, where a Factor enters a master general agreement with a customer to purchase accounts receivable, and both parties agree that the total financing is reasonably foreseeable to exceed $500,000, the relationship of such parties falls outside the scope of this law.

Commercial Financing Requiring Estimated Term Disclosures

SB 1235 requires a provider to disclose the "term or estimated term" of the contract. What commercial financing contracts may require an estimated term disclosure, and why? The Commissioner suggests that stakeholders provide sample contracts that may require an estimated term disclosure.

We support the use of the sample disclosure attached hereto.

Again, in the context of factoring, the parties enter a general agreement pursuant to which transactions are made is usually a specified term in years, which is renewable and can be terminated under certain conditions.

However, the "term" in the sample disclosure refers to the terms of a sample particular transaction, i.e., a sample purchase of a particular invoice/account receivable. The "term" of such a particular would be estimated, because while the expectation is that the account receivable purchased will be paid on the due date of the invoice purchased, payment is frequently received earlier or later than the due date.

Disclosure of Method, Frequency, and Amount of Payments for Commercial Financing with Flexible or Contingent Repayment Obligations

Some types of commercial financing offer flexible or contingent repayment obligations. The Commissioner suggests that stakeholders provide examples of these types of commercial financing. How should providers disclose to the method, frequency, and amount of payments required under such contracts?

We support the use of the sample disclosure attached hereto.

Types of Commercial Financing

The Commissioner invites stakeholders to provide examples of commercial financing transactions subject to SB 1235 other than fixed-rate, fixed-payment financing. Examples of such transactions may include those with variable interest rates, multiple, flexible or contingent repayment options, merchant cash advances, open-end credit plans, and recourse and nonrecourse factoring. What obstacles do stakeholders

anticipate in complying with SB 1235 with respect to such transactions, and how can the Commissioner's rules address those obstacles?

Factors use many different formulas and variable rates to calculate fees to their customers based on a number of different circumstances. Use of the sample disclosure attached hereto will mitigate the difficulties Factors will face in complying with SB 1235.

Types of Financing Requiring Estimated Annualized Rates

SB 1235 requires the Commissioner to determine when a provider can disclose an estimated annualized rate and how providers must calculate the estimated annualized rate. What types of commercial financing will require estimated annualized rates, and why?

There are multiple hurdles to providing an exact APR in the context of factoring, which require that a range be used instead of an exact percentage. Factors do not provide fixed-rate, fixed-payment financing. They commonly use up-front or bracketed fees and, do not control when the principal is repaid or when the fees are paid because payments are made by third parties and not the customer. Given that Factors cannot control when the principal is paid and when they can collect the fees, the APR cannot be determined until after the principal is paid. In light of these circumstances, only an APR range could be provided, in the context of providing a sample disclosure such as the sample attached hereto.

Fees and Charges Included in an Annualized Rate Calculation

What type of fees and charges should be included in an annualized rate calculation? The Commissioner requests comments relating to fees and charges for commercial financing types other than fixed-rate, fixed-payment financing.

Only fees and charges related to financing, i.e., the actual money advanced to the customer, should be included in an annualized rate calculation. As noted in the sample disclosure attached hereto, a sample disclosure should not include non-finance fees between the Factor and the customer, such as bank charges, legal, administrative, set up, late, application, misdirected or invalid invoice fees. These fees are impossible to determine up front, are not related to the actual financing, and are clearly carved out in the sample disclosure. These are different types of administrative-related fees, which are generally charged to compensate the Factor for staff time associated with communicating and receiving payments from obligors, and other associated administrative work that is independent of the cost of the financing transaction.

Explanatory and Qualifying Language in Connection with Estimated Terms and Estimated Annualized Rates

What explanatory and qualifying language should providers include when disclosing estimated terms or estimated annualized rates? How can such language minimize potential confusion for the financing applicant and assist the applicant in understanding how the provider calculated the estimate?

We support the use of the sample disclosure attached hereto, which includes language qualifying the estimate of the APR.

Disclosures for Factoring and Asset-Based Lending Transactions with Master Financing Agreements

SB 1235 allows providers of factoring and asset-based lending to provide disclosures based upon an example transaction when the providers use agreements that describe the general terms and conditions of the commercial financing transactions that will occur under the agreements. What rules, if any, should the Commissioner establish to clarify when disclosures based upon example transactions are permitted? What rules, if any, should the Commissioner establish governing what example (i.e. financing amount) the provider may use when drafting disclosures?

The Commissioner should specify that where there is a sample disclosure made pursuant to a general agreement to purchase eligible current and potential future accounts receivable and purchase orders, amounts funded over time pursuant to such an agreement shall not each require a new disclosure form for each individual funding unless the terms have changed. To require disclosures on every invoice purchased would result in thousands of disclosures, which would be very injurious to customers who may fund thousands of invoices with the Factor, and may need immediate funding.

The attached proposed sample disclosure is intended to be presented at the time of entry of the general agreement pursuant to which all transactions are made. Creating a new disclosure associated with each account receivable would negate the intent of the legislature, which is to help the customer and allow a sample disclosure to be used in situations such as those of the Factors and their customers.

Moreover, it should be clarified that SB 1235 applies to all new general agreements and shall not require the creation of a disclosure for already existing general agreements.

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?

For the reasons set forth herein, Factors can only establish a range of possible APR. Factors can establish ranges that are broad enough to encompass the possible APR outcomes.

Disclosure Formatting

SB 1235 authorizes the Commissioner to establish rules concerning the formatting of disclosures provided to financing applicants. What, if any, of the information that SB 1235 requires to be disclosed should the disclosure form(s) highlight or prioritize? Should certain disclosures appear at the top of the form(s) in larger or bold font, etc.?

We support the use of the sample disclosure attached hereto. We request that the form of the sample disclosure appear in its entirety in the regulations for the sake of clarity.

Sincerely,

Rebecca Coll

Cc: Charles Carriere
charles.carriere@dbo.ca.gov

FINANCING DISCLOSURE FORM

The Financing Agreement between ___________________(“***RECIPIENT***”) and ______________ (“***PROVIDER***”) states RECIPIENT may choose to sell their accounts receivable to ***PROVIDER*** at a certain price and ***PROVIDER*** may choose to buy such Invoice(s). Each Invoice submitted to ***PROVIDER*** from RECIPIENT under this agreement is a separate transaction incurring discrete fees on that transaction, in conjunction with all other Invoices concurrently financed, and this disclosure serves to fulfill the requirement for all transactions under the Financing Agreement and its initial contractual credit terms.

(1) Amount Financed:
PROVIDER is providing ***RECIPIENT*** a Revolving Credit Limit of $_________________ (“***Credit Limit***”);

(2) Term or Estimated Term:
The Initial Contractual Credit Term is ____ days, which will be renewed as set forth in the Financing Agreement (“***Contractual Credit Term***”);

(3) Repayment Policies:
- a. The Financing Agreement may be terminated by either party with ____days written notice;
- b. A penalty may be assessed if the Financing Agreement is terminated prior to the expiration of Contractual Credit Term. That penalty is calculated as:
  - i. Insert calculation

(4) Method, Frequency & Amount of Payments
- a. The primary source of payments is the Account Debtors (the customer of the Seller) directly to *FINANCING COMPANY* on the terms set forth in the Invoice(s);
- b. Account Debtors are sent notification under Article 9 of the Uniform Commercial Code
  - i. Yes
  - ii. No

c. [Optional Section] Invoices, or any portion thereof, which remains unpaid after ninety (90) days may be required by ***PROVIDER*** to be repurchased by ***RECIPIENT*** through cash, wire, reserve account or a replacement Invoice(s).

(5) Financing Costs:
- a. Exemplars of Financing Charges Scenarios under this Financing Agreement:

___% advance rate
[Optional] Dilution equals___%
___% first ___ days
0___% each day thereafter/ % each ____ day(s)
Bank Clearing Days (“BCD”): __ business days

30 Day Payment Cycle

Invoice Amount:		$1,000.00
[Optional] Diluted Amount	$	
Advanced Amount	$	
Payment Terms (including BCD):		30 days
Fee:	____%	
Fee Amount:	$	
Initial Reserve Generated:		$
Financing Fees APR Range	______% to _____%	

45-Day Payment Cycle

Invoice Amount:		$1,000.00
[Optional] Diluted Amount	$	
Advanced Amount	$	
Payment Terms (including BCD):		45 days
Fee:	___%	
Fee Amount:	$	
Initial Reserve Generated:		$
Financing Fees APR Range	______% to ______%	

b. [Optional Section] In the event that no Invoices are submitted to ***PROVIDER*** by ***RECIPIENT*** during any calendar month, RECIPIENT shall be liable to ***PROVIDER*** For a Minimum Monthly Fee equal to ____% of the Credit Limit;

c. The ***FINANCING AGREEMENT*** does include other potential non-finance fees between ***RECIPIENT*** and ***PROVIDER*** and thus, this example will exclude any of those potential fees *such as* bank charges, legal, administrative, set up, late, application, misdirected or invalid invoice fees.

Read and Signed:

____

Name and title ____

Date ____

Proposed Guidelines for Regulations

- The cumulative amount of potential financing offered pursuant to a general agreement to purchase Eligible Accounts Receivable and Eligible Purchase Orders shall be used to calculate whether a specific commercial financing offer is equal to or less than five hundred thousand dollars ($500,000), even if accounts receivable and purchase orders totaling that amount are not ultimately purchased, subject to the cumulative amount reflecting an amount that the parties agree in writing is reasonably foreseeable over the course of the relationship of the provider and recipient. Eligible Accounts Receivable means accounts receivable which actually exist when funding occurs. Eligible Purchase Orders means purchase orders which actually exist when funding occurs.

- Where there is a sample disclosure made pursuant to a general agreement to purchase eligible current and potential future accounts receivable and purchase orders, amounts funded over time pursuant to such an agreement shall not each require a new disclosure form for each individual funding unless the terms have changed.

- This section applies to all new agreements and shall not require the creation of a disclosure for already existing agreements.

Proposed Definitions

- "Specific Commercial Financing Offer" means the aggregate of all potential Commercial Financing transactions offered pursuant to a general agreement to purchase Eligible Accounts Receivable and Eligible Purchase Orders during the initial contractual credit term, which is agreed upon in writing by the parties to the agreement as the amount that is reasonably foreseeable to be offered over the course of the relationship of the parties.

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