STATE FINANCIAL
CORPORATION

SINCE 1967

January 17, 2019

Department of Business Oversight
1515 K Street
Suite 200
Sacramento Ca. 95814-4052
By email: regulations@dbo.ca.gov

Re: PRO 01-18

Department of Business Oversight:

Thank you for the opportunity to comment on regulations to implement SB1235.

State Financial Corporation is an "asset based lender" licensed by the Department of Business Oversite. State Financial has been in business for nearly 52 years and I have been in the industry for 37 years. I am the past president of the Commercial Finance Conference of California an industry trade group founded in 1971. (I submit this letter on behalf of State Financial, not as a representative of the Commercial Finance Conference of California.) While I am most familiar with the operations of State Financial, I believe I can speak intelligently about operations of the industry as a whole.

Before commenting on the specifics of SB 1235 and some of the questions raised in the invitation, I think it important to describe the operations of the industry.

Availability
State Financial like others in the industry provides Accounts Receivable loans. Accounts receivable loans are revolving loans. The amount available under an accounts receivable line of credit is generally capped by a maximum line amount, and within the line, advances are limited to a percentage of the borrowers "eligible accounts receivables." Most limit eligible accounts to those within 90 days of invoice date, but various other rules often further define eligibility. The amount of accounts changes constantly as a borrower generates new invoices and collects payment on old invoices. Thus availability changes constantly. Many of State Financial's clients report new sales daily and receive payments daily

Many in the industry offer inventory loans. Inventory loans are also revolving loans, availability is based on the value of eligible collateral. Again, availability changes as the value of a borrower's "eligible inventory" changes.

Borrowing
Within the line of credit and the percentage of eligible accounts a borrower may request advances. Borrowers typically request advances frequently to cover changing needs– payroll, taxes, supplier

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payments. Again, many of State Financial's customers borrow daily, borrowing only what's needed for that day. This way loan balances are kept at a minimum

Inventory loans are generally adjusted less frequently.

Repayment

Accounts receivable loans are repaid through collections of all accounts receivable. Through one means or another collections are remitted to the lender and credited against the loan balance.

Loan Balance

Thus, an accounts receivable loan balances change daily as advances are made and accounts receivables are paid.

Interest

Interest is generally calculated on the outstanding daily balance at an annual rate plus a base rate, typically the prime rate of interest. For instance the rate may be "prime plus 6." Prime today is 5.5%. Thus, in this example the annual rate would be 11.5%. To calculate the monthly charge the annual interest rate is divided by 360 (or 365 days) and multiplied by that day's outstanding loan balance. At the end of every month the sum of daily charges is added to the principal loan balance.

Float or Clearance Days

In addition, most all lenders charge float. For purposes of availability, collections are immediately applied to the loan balance. However, for the purpose of interest calculation most lenders charge as if the collection was not received for an agreed number of days. (Stated another way, most lenders continue to charge interest on the amount collected for an agreed number of days.) Many lenders charge float using business days. Float has been a standard in the industry for at least 50 years.

Incidental Fees

Most lenders charge for certain out of pocket expenses. For instance, returned item or other bank fees.

State Financial makes all of the charges described above, but not those in the next paragraph.

Other Fees

Other lenders have a collateral management fees (a rate charged on the borrowers total accounts receivable at month end), or unused line fee (rate charged fee on the difference between the month's average loan balance and total line of credit.

Proposals

Sometime during the underwriting process most lenders provide a written term sheet outlining these fees. State Financial does so, and most often we discuss these fees before we meet a prospective client.

State Financial
State Financial's charges consist of two one time fees, a fixed audit fee and fixed line fee; two monthly fees, interest and float; incidental bank charges, e.g. bad check fees wire fees; and potentially a minimum monthly interest fee ($500) and an early termination fee.

Difficulties with SB1235
State's difficulties with SB1235 are twofold. Impossibility of calculation; misleading disclosure.

Disclosing the interest rate is sensible, but a dollar cost is not amenable to calculation. The nature of a revolving line is variation. The daily balance is impossible to know. Also, the prime rate may change, it has done so 4 times in the past year.

To calculate the charge on the total line of credit is misleading. Monthly interest is charged on the loan balance not the line amount. Normally the total line is set at an amount higher than the initial line to allow for daily variations and growth. It is the rare borrower who believes their business is not growing. Commonly, State Financial will provide a line of credit half again as great as the initial borrowing.

It would be possible and not misleading to disclose the dollar cost per $100,000 for the interest component of charges, but the float component is not amenable to this disclosure.

The float formula can easily be disclosed. ((amount collected) x (# of agreed float days) x (annual interest rate) ÷360). After that providing a dollar cost becomes speculative. The cost depends on the dollar amount of a borrower's collections. Unsophisticated borrows may have a poor idea of their collections. A lender should not be responsible for an accurate estimate. A lender should not be a risk because the calculation is correct but based on an inaccurate estimate. Calculation is even more speculative if business days are used the amount charged may depend on the day of the week collected.

A cost per $100,000 type disclosure unmoors the float component from the interest. There is no real relationship between a $100,000 average loan balance and any particular volume of collections.

Disclosing the interest rate on a "prime plus" basis plus disclosure of the method of float calculation should be sufficient.

State Financial's one-time audit and line fees are fixed dollar fees can easily be disclosed. They could be added into a dollar cost calculation. But added to a dollar cost calculation would not make an otherwise speculative number concrete.

Wire fees and return check fees cannot be estimated. Some borrowers borrow daily, others weekly, others less frequently. Commonly, when entering into a deal a Borrower has no idea how often they will borrow.

Minimum interest and early termination fees are also best left to disclosure. State's minimum interest is $500. If actual interest and float exceeds $500, there is no charge, if actual interest and float is for example $450, the borrower pays an additional $50. Borrower's don't assume they will pay off early. If they do, at State it is a fixed fee.

Illustrations
I understand the DBO is considering requiring lenders provide an illustration of costs. An illustration is not amenable to comparison. I understand the intent of the law is to allow borrowers to compare total cost. Illustration doesn't help determine a borrower's average loan balance or collection volume.

Summary
Asset based loans are not merchant cash advance transactions. A merchant cash advance is made in a fixed amount with a fixed repayment. Asset based loans revolve. Projection of dollar cost is possible for merchant cash advance transactions but is not feasible for receivable or inventory based asset based loans. The DBO must avoid forcing round peg asset based loans, into square hole merchant cash advance regulations.

I recommend that the DPO require all fees be disclosed along with the method of calculation. If the DPO agrees but believes this is outside the mandate of SB 1235, I suggest the DPO share its findings with the legislature and recommend amendments to SB 1235 so that California borrowers can gain meaningful disclosure.

Sincerely,

State Financial Corporation

Gary Reiss
President

cc: Charles Carriere
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