RESPONSIBLE BUSINESS LENDING COALITION

April 27, 2021

Charles Carriere, Senior Counsel
Jesse Mattson, Senior Counsel
Department of Financial Protection and Innovation
One Sansome Street, Suite 600
San Francisco, CA 94101
Via electronic mail: regulations@dfpi.ca.gov, charles.carriere@dbo.ca.gov, jesse.mattson@dfpi.ca.gov

RE: Commercial Financing Disclosures Rulemaking, File No. PRO 01-18

Dear Mr. Carriere and Mr. Mattson,

Today we face the prospect of lasting damage to the small businesses that help produce California's middle class and the fabric of our local communities. When we drive past the closed storefronts in our towns and cities, we need no reminder that small businesses are devastated, desperate for help, and more vulnerable than ever to irresponsible lending.

The Responsible Business Lending Coalition ("RBLC") is grateful for this opportunity to comment on the implementation of SB 1235, which will provide meaningful protection to our small businesses community as it recovers. The RBLC is a nonprofit/industry coalition of community development organizations, fintechs, consumer and small business advocates, and small business lenders that have come together in response to the growing problem of predatory small business financing. The RBLC understands that many consumers are also small business owners who very frequently act as consumers when making financial decisions.

We thank the California Department of Financial Protection and Innovation ("Department") for working hard to protect small businesses by promulgating regulations per SB 1235 that will protect our small business owners. The one area we would like to see improved upon is in the reporting of APR and payment amounts. Under the currently proposed rules, merchant cast advance companies can low-ball that information without anyone knowing. AB 1864, which passed since these rules were drafted, provides the Department newly defined authority to address this problem.

The proposed rules must be slightly modified to ensure that merchant cash advance companies' flexibility in disclosure estimations is paired with sufficient accountability.

As you know, the calculations of estimated payment amount, term, and APR for merchant cash advances are calculated based on a projection of the small business borrower's future sales. The proposed rule section §2091 wisely establishes two methods by which these projections can be determined for disclosure calculation purposes. The default is the highly proscriptive "Historical Method," which is structured to avoid being "gamed" by financing companies that would seek to underestimate their APRs.

An additional, flexible "Underwriting Method" option is offered to enable providers to establish these projections though their own discretion. This Underwriting Method is a valuable alternative to the historical method for financing providers sophisticated enough to reflect sales trends, seasonality, or expected future sales events in their projections. The Underwriting Method should be maintained in the rules and should not be removed.

However, as currently written, the flexibility of the Underwriting Method is not paired with sufficient accountability to prevent its abuse. As currently written, providers using the Underwriting Method would instead conduct their own internal assessment of whether their disclosures have been sufficiently accurate. This creates two problems:

> A) There is little or no accountability: The Department will have no way of knowing whether the required internal assessment has taken place. If the internal assessment is conducted, and finds that a merchant cash advance company's payment amount and APR disclosures are unacceptably low, the Department will have no way of knowing whether the required changes are made to improve the disclosure. These companies will know that the Department is the dark. Relying on self-policing by an industry regularly compared to pre-crisis subprime mortgage lending is insufficient.[1]
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> B) The Department will be unable to learn and improve the rules: The rules establish accuracy tolerances of 10% and 5% for use of the Underwriting Method. We do not know whether these tolerance thresholds are too restrictive or too permissive. Without reporting, the Department may never know, and will be unable to make informed regulatory decisions to adjust these thresholds.

Both problems would be solved if financing companies that choose to use the flexible "Underwriting Method" are required to report data to the Department.

Acknowledging that modifying the proposed rules may slow its implementation, we submit that the need to prevent merchant cash advance companies from low-balling their payment amount and APR disclosures warrants this revision.

Sincerely,

The Responsible Business Lending Coalition

California Association for Micro Enterprise Opportunity

[1] See, e.g. Shin, Laura, Forbes, "Why Online Small Business Loans are Being Compared to Subprime Mortgages," Dec 2015. https://www.forbes.com/sites/laurashin/2015/12/10/why-online-small-business-loans-are-being-compared-to-subprime-mortgages/#1afdbb592889