



August 24, 2021

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 Department of Financial Protection and Innovation  
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**RE: Commercial Financing Disclosures Rulemaking, File No. PRO 01-18**

Dear Mr. Carriere and Mr. Mattson,

A rising tide cannot lift all boats when many boats are beached on the shore, pummeled by large waves. Throughout the pandemic, small businesses have struggled to survive, and even to access the aid designed to carry U.S. businesses through the COVID-19 shutdown. This has been especially true of businesses operated by women and minorities.

As small businesses are struggling, some financing companies promise fast, easy money as a lifeline, but at terms that are not transparently disclosed and can ruin a small business. DFPI's implementation of the first small business truth in lending standards in the U.S. is critical to protecting small businesses and rebuilding a healthy economy.

The Responsible Business Lending Coalition ("RBLC") and other co-signed organizations are 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, Fintech, consumer and small business advocates, and small business lenders that have come together in response to the growing problem of predatory small business financing.

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. We suggest three changes to the proposed rule to better accomplish the goals of the law to the benefit of small businesses, local communities, financing providers, and the Department itself:

1. **Disclosure must enable comparison between financing options** - Clarify that, in instances where multiple financing options are being presented, the full disclosure is to be made available on *all* options to aid comparison between them, rather than on the *single* option the applicant chooses to move forward with.
2. **Prevent misleading "gaming" of APR estimations** - Ensure that merchant cash advance companies' *flexibility* in estimating terms for disclosure is paired with sufficient *accountability* by requiring reporting to DFPI that compares any estimated terms disclosed vs. the actual terms determined retrospectively.
3. **Formatting requirements should permit additional flexibility** – Ensure that there is sufficient flexibility for disclosures to appear effectively on mobile devices and address unforeseen formatting challenges. We suggest principle-based rules rather than prescriptive rules such as certain font size.

In the following letter, we discuss each of these recommendations in greater detail.

### **Recommendation 1: Disclosure must enable comparison between financing options**

The legislature's intent in passing SB 1235 is to enable small businesses to make informed cost comparisons between the different financing options available to them. However, a change proposed by the Department in the most recent revision of the rules may inadvertently create a loophole that could undermine this comparison function in important circumstances.

The recent revision includes new language that may be interpreted to permit a delay of the disclosure until after the small business's decision-making process has taken place. This certainly was not the intent of the Department.

However, if the terms required for a transparent disclosure are not presented until after the small business has selected among several financing offers, the disclosure is not useful for comparing financing options and the legislative intent of SB 1235 is not upheld.

The new language of concern dictates that, when a provider is presenting multiple financing offers, the disclosure would be presented to the recipient “at the time the recipient selects a preferred option” (2057. Definitions (a)(4)(A)). This language must be revised or clarified to make explicit that the disclosure should be available for any offer that the recipient considers, rather than for a single offer the recipient selects to move forward with. At that point, the disclosure is too late.

This concern may appear in practice in several scenarios. In one scenario, a provider may present several discrete financing options for the recipient to consider. For example, a financing marketplace may present offers for loans from several different providers. Or, a provider may present a loan from a single provider where the applicant may select a 1-year, 3-year, and 5-year term option, each with a different price.

These offers may carry substantially different APRs. We acknowledge that it may not be possible to present the full disclosure for several offers on a single page or screen. However, if the small business only sees the APR disclosed on the single option they would like to move forward with, a comparison based on APR would not be possible. This would represent a significant and unacceptable loophole that could grow to encompass much of the financing market. Providers may elect to present multiple offers at once, in a manner that includes customization options, in order to avoid a meaningful disclosure process. Many small businesses would find themselves overcharged with unnecessarily expensive financing.

The solution is simple. A small business should be able to see the full disclosure for any option they would like to learn more about. Once a small business reviews the required disclosure on a single selected option, they should be able to return to the list of options and then select another option to consider. If, upon viewing the disclosure, the recipient must use the “back” button in the browser to return to the list of options, the recipient is unduly guided forward away from the comparison process. A link or button to return to the list of options should be included.

This might be accomplished by replacing the language of “selects a preferred option” with “selects an option for consideration.” Alternately, the Department could clarify that the phrase “selects a preferred option” means that a “preferred option” is selected for more information, with a link or button option to return to the list of other options if the process is online, and that the “preferred option” need not be selected at the exclusion of other options.

For SB 1235 regulations to be most helpful, whenever multiple offers are presented, the APR would be included in each summarized offer.

In a second scenario, a provider may present an offer online that can be dynamically updated, such as through slider bars. Some commenters have suggested that this would require a confusingly large proliferation of disclosure forms as an offer is customized, but that need not be the case.

As a slider bar provides dynamic results, the same functionality can be used for the required disclosure to update dynamically. The disclosure form should simply accompany the slider bars or other offer customization interface. As the slider bar is moved, the terms in disclosure form that accompanies the offer should also change. If a “term”

slider bar is moved from 24 months to 12 months, the “term” displayed in the disclosure form on the same page should update from 24 to 12, while the APR, payment amount, and other terms update accordingly.

The most transparent form of dynamic updating might place the “slider bar” or similar feature within the required disclosure itself. This way, within the required disclosure form, the applicant could customize the terms among the offers available to them.

This most transparent and useable experience would be supported by DFPI’s adoption of our third recommendation below, which is to permit a flexible, principles-based approach of incorporated the required disclosure terms into the “look and feel” of a given provider’s user interface.

Some providers may argue that it is cumbersome to present the full required disclosure on the same page as a customizable offer summary, as described above. That is another way of saying that the provider does not want to include the required disclosures while they are presenting an offer.

If the provider is presenting a price and amount, then they are able to include the APR and the other required terms. Delaying the APR disclosure would enable the provider to guide the small business’s decision-making process without knowledge of the APR, which is contrary to the intent and language of SB 1235 which requires disclosure at “the time of extending a specific commercial financing offer.”<sup>1</sup>

## **Recommendation 2: Prevent misleading “gaming” of APR estimations**

Under the currently proposed rules, sales-based financing companies (i.e. products such as merchant cash advances) could low-ball the APRs they disclose without anyone knowing. AB 1864, which passed since these rules were drafted, provides the Department newly defined authority to address this problem.

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:

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<sup>1</sup> California Senate, “Senate Bill No. 1235,” Oct. 2018.  
[https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill\\_id=201720180SB1235](https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201720180SB1235)

A) The proposed regulations offer 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.<sup>2</sup>

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. These disclosure requirements could also be pursued through the Department’s Draft Regulations Related to Complaints and Small Business Protections.

**Recommendation 3: Formatting requirements should permit additional flexibility**

For the required disclosure to be effective, it must be functional on mobile devices. We suggest some flexibility may also be desirable, as user experiences may develop in unanticipated ways.

The prescribed table with three columns and generally eight rows may be cramped on some mobile devices with smaller screens. In these cases, it is possible that the information in each row may be better displayed with the information appearing stacked vertically, rather than laid out in rows. For example:

The APR row is currently prescribed as:

Annual Percentage Rate (APR)	15.4%	<p>APR is the cost of your financing expressed as a yearly rate. APR includes the amount and timing of the funding you receive, interest and fees you pay and the payments you make.</p> <p>Your APR is not an interest rate. Your interest rate is [interest rate]. Your APR may be higher than your interest rate because APR incorporates interest costs and other finance charges.</p>
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<sup>2</sup> 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>

It may be possible to display more clearly on mobile with another design, such as this:

Annual Percentage Rate (APR)	15.4%
APR is the cost of your financing expressed as a yearly rate. APR includes the amount and timing of the funding you receive, interest and fees you pay and the payments you make.	
Your APR is not an interest rate. Your interest rate is [interest rate]. Your APR may be higher than your interest rate because APR incorporates interest costs and other finance charges.	

We applaud the Department for the inclusion of flexibility in § 2060. General Requirements (7)(a), which states that, “The provider may present the required disclosure in fonts and colors that are clear, complete, conspicuous, easy to compare with other disclosures, and consistent with the requirements of this Chapter.” Similar flexibility with respect to layout may also be appropriate, provided that the order of the required elements be maintained.

Similarly, font sizes larger than the prescribed sizes of “similar in size to Times New Roman 12- to 14-point font” for the columns one and two, and larger than “10- to 12-point” for column three, may be appropriate in some designs. For example, the prescribed fonts in columns 1 and 2 above appear small, compared to the available white space. We support the Department’s new inclusion of § 2060. General Requirements (7)(d), which permits larger fonts where “necessary to comply with the Americans with Disabilities Act.” There may be cases where larger fonts may not be necessary for the Americans with Disabilities Act but generally improve the clarity or appearance of the required disclosure. We suggest the font size requirements be modified to “not smaller than” to permit this flexibility.

Thank you for this opportunity to comment. We look forward to the Department of Financial Protection and Innovation’s finalization of these disclosures for the good of California’s small businesses.

Sincerely,

1. The Responsible Business Lending Coalition

Members include: Accion Opportunity Fund, Community Investment Management, Funding Circle, LendingClub, Opportunity Finance Network, Small Business Majority, and the Aspen Institute

2. Access Plus Capital

3. Accessity

4. Accion Opportunity Fund

5. American Fintech Council

Board members include: Affirm, Avant, Cross River, LendingClub, Marlette Funding, Prosper, SoFi, Upstart, and Varo

6. AmPac Tri-State CDC

7. ANewAmerica

8. Arcata Economic Development Corporation (AEDC)

9. Asian Business Association
10. Asian Business Association of the Inland Empire
11. Asian Pacific Islander Small Business Program (APISBP)
12. Bankers Small Business CDC of California
13. Bethel LA Community Development Corporation
14. Black Business Association
15. Business Center for New Americans
16. C.O.O.K. Alliance
17. CA WBC Network
18. California Asian Chamber of Commerce
19. California Asset-Building Coalition
20. California Association for Micro Enterprise Development (CAMEO)
21. California Black Chamber of Commerce
22. California Capital Financial Development Corporation
23. California Hispanic Chambers of Commerce (CAHCC)
24. California Reinvestment Coalition (CRC)
25. California Small Business Development Center (SBDC) - Valley Community
26. CDC Small Business Finance
27. CNote
28. Colorado Lending Source
29. Common Capital
30. Community Housing Opportunities Corporation (CHOC)
31. Community Investment Management (CIM)
32. Community Vision
33. Consumer Advocacy and Protection Society at Berkeley Law
34. Consumer Advocates Against Reverse Mortgage Abuse
35. Consumer Federation of California
36. Core Performance
37. Crane Works
38. Economic Development & Financing Corp. (EDFC)
39. El Concilio of San Mateo County
40. El Parajo Community Development Corporation
41. Faith and Community Empowerment (FACE)
42. Fresno Area Hispanic Foundation
43. Funding Circle
44. Go Local Sonoma County
45. The Greenlining Institute
46. Halo Business Finance
47. Hispanic Chambers of Commerce of San Francisco (HCCSF)
48. Housing and Economic Rights Advocates (HERA)

49. ICA Fund Good Jobs
50. Inclusive Action for the City
51. Inland Empire Regional Chamber of Commerce
52. International Rescue Committee San Diego
53. Invest in Women Entrepreneurs Initiative
54. Jefferson Economic Development Institute (JEDI)
55. Latino Business Network & Allies
56. LendingClub
57. Lighter Capital
58. Main Street Launch
59. Mission Economic Development Agency (MEDA)
60. Montecito Bank & Trust
61. Mountain Biz Works
62. Multifunding
63. National Federation of Filipino American Associations (NaFFA)
64. North Bay Jobs with Justice
65. Northern California Small Business Development Corporation (Nor-Cal FDC)
66. Opening Doors
67. Pacific Asian Consortium in Employment (PACE)
68. Pacific Community Ventures (PCV)
69. Primestor Investments, LLC
70. Prospera Community Development
71. Public Law Center (PLC)
72. Renaissance Entrepreneurship Center
73. Sac Black Biz
74. Silver Lining
75. Small Business California
76. Small Business Majority
77. StreetShares
78. TELACU Education Foundation
79. The Woodstock Institute
80. Time for Change Foundation
81. Venturize
82. Vermont Slauson Economic Development Corporation (VSEDC)
83. Veteran Launch
84. Wadeco Business Center
85. Women's Economic Ventures (WEV)
86. Working Solutions CDFI
87. 3 Core