

Date of Hearing: June 12, 2023

**ASSEMBLY COMMITTEE ON BANKING AND FINANCE**

Timothy Grayson, Chair

SB 33 (Glazer) – As Introduced December 5, 2022

**SENATE VOTE:** 39-0

**SUBJECT:** Commercial financing: disclosures

**SUMMARY:** Removes the January 1, 2024 sunset date for the requirement that a commercial financing provider include “total cost of financing expressed as an annualized rate” in its required disclosure to financing recipients.

**EXISTING LAW:**

- 1) Establishes disclosure requirements related to commercial financing. (Division 9.5 of the Financial Code Sec. 22800, et seq.)
- 2) Defines “commercial financing” as an accounts receivable purchase transaction, including factoring, asset-based lending transaction, commercial loan, commercial open-end credit plan, or lease financing transaction intended by the recipient for use primarily for other than personal, family, or household purposes. (Financial Code Sec. 22800 (d))
- 3) Defines “recipient” as 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). (Financial Code Sec. 22800 (n))
- 4) Requires a provider of commercial financing to disclose the following information to a recipient at the time of extending a specific commercial financing offer to that recipient:
  - a) The total amount of funds provided.
  - b) The total dollar cost of the financing.
  - c) The term or estimated term.
  - d) The method, frequency, and amount of payments.
  - e) A description of prepayment penalties.
  - f) Until January 1, 2024, the total cost of the financing expressed as an annualized rate. (Financial Code Sec. 22802)
- 5) Allows a provider of commercial financing that is factoring or asset-based lending to offer, instead of #4 above, the following:
  - a) An agreement that generally describes the general terms and conditions of the commercial financing transaction that will occur under the agreement, and

- b) The same information as described in b) – f) of #4 above based on an example transaction that could occur under the general agreement for a given amount of accounts receivable. (Financial Code Sec. 22803)
- 6) Subjects providers licensed under the California Financing Law to examination and enforcement by the Department of Financial Protection and Innovation (DFPI) for any violation of the disclosure requirements. (Financial Code Sec. 22805)
- 7) Exempts the following entities or transactions from the disclosure requirements:
  - a) Depository institutions.
  - b) Lenders regulated under the federal Farm Credit Act.
  - c) A commercial financing transaction secured by real property.
  - d) A commercial financing transaction in which the recipient is a dealer or a vehicle rental company, as specified, pursuant to a specific commercial financing offer or commercial open-end credit plan of at least fifty thousand dollars (\$50,000), including any commercial loan made pursuant to such a commercial financing transaction.
  - e) Any person who makes no more than one commercial financing transaction in California in a 12-month period or any person who makes five or fewer commercial financing transactions in California in a 12-month period that are incidental to the business of the person relying upon the exemption. (Financial Code Section 22801)

**FISCAL EFFECT:** Unknown. This bill is keyed Fiscal by Legislative Counsel.

**COMMENTS:**

1) Purpose

According to the author:

As the need for capital has continued to grow, new forms of financing have developed to help entrepreneurial Californians receive the monetary means of starting or improving their businesses. This new market place had gone unregulated until I introduced and passed SB 1235. With the passage of SB 1235, California became the first state in the nation to require commercial finance companies to provide Truth-in-Lending disclosures to small business borrowers, allowing borrowers to more easily comparison shop and understand the true cost of the money they are borrowing. Included in the disclosure requirements was the need for financial providers to disclose the total cost of their financing as an annualized rate. Early versions of the measure called for calculating the annualized rate using a metric that was untested in California or any other state, this led the then-chair of the Senate Judiciary Committee to include a sunset provision on the untested metric. However, the bill was later amended to delegate the choice of metric to the Department of Financial Protection and Innovation (DFPI.) The department has since adopted the familiar and long-tested Annual Percentage Rate, or APR for that metric. With the removal of the untested metric,

the sunset clause became unnecessary. Small businesses should be able to benefit from truth-in-lending indefinitely; especially when the money they are borrowing, to begin or improve their business, could prove overburdening. SB 33 will eliminate the sunset to ensure that small business borrowers can continue to benefit from truth-in-lending disclosures that allow them to compare apples-to-apples and make the best financial decisions for their businesses, their families, and themselves

## 2) California's commercial financing disclosure rules

Small businesses must navigate a highly complex, fragmented, and quickly-evolving lending market. For even savvy borrowers, understanding available options can be time-consuming and confusing, made more difficult because commercial financing is not covered by long-established federal statutes such as the Truth in Lending Act (TILA). As the Consumer Financial Protection Bureau (CFPB) notes about the small business lending market:

The market is fragmented across numerous different product types, making small business lending very different from residential mortgage lending. Among other sources of financing, small businesses use credit cards and lines of credit; equipment, vehicle, and other closed-end loans, both secured and unsecured; and merchant cash advances. Some lenders offer a variety of products while others specialize.<sup>1</sup>

In response to the proliferation of complex and costly commercial lending products, the Legislature passed SB 1235 (Glazer), Chapter 1011, Statutes of 2018, to require DFPI to establish standardized commercial financing disclosures. SB 1235 aimed to create the first “small business truth in lending law” in the nation to help small business borrowers compare and evaluate the varied financing options available to them.

SB 1235 tasked DFPI with developing the following disclosures for small business borrowers: (a) the total amount of funds provided; (b) the total dollar cost of the financing; (c) the term or estimated term, the method, frequency and amount of payments; (d) a description of prepayment penalties; and, (e) until January 1, 2024, the total cost of financing expressed at an annualized rate.

Importantly, SB 1235 also differentiated the above disclosures for asset-based lending and factoring products, which do not have defined payment terms. Specifically, SB 1235 authorized a provider to give the borrower the above disclosures as part of “an example of a transaction that could occur under the general agreement for a given amount of accounts receivable.”

While SB 1235 became law in 2018, the bill's provisions only recently took effect in December 2022 following an extensive regulatory process. In its press release celebrating the

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<sup>1</sup> [https://files.consumerfinance.gov/f/documents/cfpb\\_small-business-lending-rule-fact-sheet\\_2023-03.pdf](https://files.consumerfinance.gov/f/documents/cfpb_small-business-lending-rule-fact-sheet_2023-03.pdf)

final regulations, DFPI stated the new disclosures “will assist small businesses in making more informed decisions about the potential costs of various commercial financing options.”<sup>2</sup>

### 3) Types of commercial financing

A wide range of financing products falls within the scope of SB 1235’s standardized disclosures. The Senate Banking and Financial Institutions Committee succinctly summarized these financing options as follows:

- *Closed-end transaction* means a transaction in which credit is extended only once over a specific term and is repaid (a) in regular predetermined payments of a specified amount over a fixed period of time or, (b) in the case of sales-based financing, in payments calculated as a percentage of sales or income, but with a minimum required payment or payments such that the recipient is eventually required to repay the amount advanced regardless of the sales or income the recipient collects. An example of a transaction with a repayment feature described by (a) is a traditional installment loan.
- *Sales-based financing* means a commercial financing transaction that is repaid by a recipient to the financier as a percentage of sales or income, in which the payment amount increases and decreases according to the volume of sales made or income received by the recipient.
- *Asset-based lending* means a transaction in which advances are made from time to time contingent on a recipient forwarding payments received from one or more third parties for goods the recipient has supplied or services the recipient has rendered to that third party or parties.
- *Open-end credit plan* means a provider’s plan for making open-end loans pursuant to a loan agreement that sets forth the terms and conditions governing the use of the open-end credit program, similar to a revolving credit card.
- *Factoring* means an accounts receivable purchase transaction that includes an agreement to purchase, transfer, or sell a legally enforceable claim for payment held by a recipient for goods the recipient has supplied or services the recipient has rendered that have been ordered but for which payment has not yet been made.
- *Lease financing* means providing a lease for goods if the lease includes a purchase option that creates a security interest in the goods leased.

### 4) The debate around Annual Percentage Rate (APR)

SB 33 has reignited the debate over the usefulness of APR as a standardized measure for commercial financing products. Before evaluating SB 33’s sunset removal, it is worth reviewing how APR works and why it has become so commonplace.

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<sup>2</sup> <https://dfpi.ca.gov/2022/06/14/dfpis-commercial-financing-disclosure-regulations-approved-to-become-effective-as-of-december-9-2022/>

Generally speaking, APR allows people to compare the relative cost of a loan or financing product by taking into account interest, fees, and the repayment period. Policymakers, regulators, and consumer advocates typically embrace APR as a way to compare different products, even if those products have varying rates, repayment schedules, and fee structures.

APR is a useful metric in part because it incorporates a loan's repayment period and "the time value of money." The length of time the borrower has to repay the financing or loan is relevant information, especially for a business managing its cash flow. Paying back a \$10,000 loan in a one-month period is much different than paying back the same loan in a 12-month period, even if the borrower's total costs are same. And APR appears to be important to small businesses: Focus group research from the Federal Reserve found that participating business owners found APR among the most helpful details in a sample disclosure.<sup>3</sup> As SB 33 supporters note:

APR is the cornerstone of price transparency. APR is simply the full cost of the financing over a common unit of time. APR can be calculated for any type of product--it's just math. That's why APR has been the standard measure of the price of financing since the Federal Truth in Lending Act passed in 1967

However, APR, like any metric, has limitations. The math of annualizing means that a short-term loan that a borrower would typically consider affordable can still carry a high APR, which a borrower may perceive as a high cost. For business financing products like sales-based lending and factoring, which do not have scheduled payment terms and are not structured like traditional consumer loan products, APR presents several mechanical challenges. Any APR calculation for these products must make assumptions to project a likely payment schedule, which means the number is subject to uncertainty. Industry stakeholders have long argued APR is unhelpful and counterproductive in certain contexts, in part due to these factors.<sup>4</sup>

SB 33 restarts this debate by proposing to make permanent SB 1235's "total cost of the financing expressed at an annualized rate" disclosure. Under DFPI's final regulations, a lender must provide an APR to satisfy this disclosure requirement. For sales-based financing and factoring, DFPI allows for an "Estimated APR" figure, and DFPI requires a provider to: (a) Disclose an "Estimated APR" figure, calculated using prescribed methodologies; and, (b) Disclose that the APR is an estimate and that the recipient's APR may vary. As an illustrative example, DFPI specifies the following Estimated APR disclosure for sale-based financing:

APR is the estimated cost of your financing expressed as a yearly rate. APR incorporates the amount and timing of the funding you receive, fees you pay, and the periodic payments you make. This calculation assumes your estimated average monthly income through [description of particular payment channel or mechanism] will be [average monthly income estimate determined in accordance

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<sup>3</sup> <https://www.federalreserve.gov/publications/files/what-small-business-borrowers-find-when-browsing-online-lender-websites.pdf>

<sup>4</sup> <https://debanked.com/2020/10/steve-denis-talks-about-sbfa-study-apr-is-a-bad-metric-for-smb-loan-transparency/>

with sections 930 or 931]. Since your actual income may vary from our estimate, your effective APR may also vary.<sup>5</sup>

DFPI’s regulations make clear that the APR disclosure will be more complicated for certain types of commercial financing and go to great lengths to lay out clear guidelines for how providers must proceed. In those cases, providers are granted flexibility in producing the estimate based on either the “historical method,” which takes into account a recipient’s prior sales data, or the “underwriting method,” which allows a provider to use the best information reasonably available to establish the estimate.

A key question for committee members is whether APR, however imperfect it may be, is worth keeping around for California’s commercial financing disclosure rules. It is undeniably true that APR is challenging for some providers. SB 33 has attracted significant opposition from providers that have difficulty navigating the disclosure rules promulgated by DFPI. It is also true that APR can offer a small business unique information the other disclosures do not.

Moreover, the same reasons why APR is so difficult to estimate for some commercial financing products can support an argument for the importance of requiring APR disclosures. Factoring and sales-based financing can be complicated and opaque, and organizations like the Federal Reserve have been critical of the fees and costs associated with those products.<sup>6</sup> It is a worthy endeavor to give businesses a variety of data points, with the appropriate caveats, so they can make fully informed decisions when obtaining commercial financing.

Finally, the below table, provided by supporters, shows the relative differences in APR for different financing products that have the same total costs but different terms. These numbers are hypothetical, but they demonstrate how APR can differ by financing product.

| Regulatory Transaction Category | Example Marketing Name     | Financing Amount | Total Dollar Cost of Financing | Term or Estimated Term                         | Payment or Estimated Payment                       | Payment Method & Frequency               | Annualized Rate (APR or Estimated APR) |
|---------------------------------|----------------------------|------------------|--------------------------------|--|--|--|--|
| Closed-end                      | Term loan                  | \$100,000        | \$20,000                       | 5 years  | \$2,000  | Monthly ACH                              | 7%                                     |
| Sales-based financing           | Merchant cash advance      | \$100,000        | \$20,000                       | 6 months (though often renewed multiple times) | Estimated \$667/day, equal to about \$20,000/month | Daily % cut of sales paid by credit card | 75%                                    |
| Asset-based lending             | Asset-based line of credit | \$100,000        | \$20,000                       | 1 year   | \$10,000   | Monthly Check                            | 35%                                    |
| Open-end credit plan            | Line of credit             | \$100,000        | \$20,000                       | 2 years  | \$5,000  | Monthly ACH                              | 18%                                    |
| Factoring                       | Factoring                  | \$100,000        | \$20,000                       | 120 days                                       | no regular payments                                | Invoice sold to factoring company        | 80%                                    |
| Lease financing                 | Lease                      | \$100,000        | \$20,000                       | 3 years  | \$3,333  | Monthly ACH                              | 12%                                    |

<sup>5</sup> <https://dfpi.ca.gov/2022/06/14/dfpis-commercial-financing-disclosure-regulations-approved-to-become-effective-as-of-december-9-2022/>

<sup>6</sup> <https://www.atlantafed.org/community-development/publications/partners-update/2020/01/200108-report-on-minority-owned-small-businesses>

5) What about litigation?

Opponents express concern that a small business owner can sue a provider because the realized APR, despite being advertised as an estimate, did not reflect the disclosed number. As the Revenue Based Finance Coalition (RBFC) argues, “Requiring a financing provider to disclose the cost of financing based on assumptions and estimates creates significant legal liability simply for following California law.” While SB 1235 did not grant a private right of action, opponents point to several other laws that would allow a business owner to bring legal action, including the Unfair Competition Law and California’s False Advertising Law.

It is worth noting that a “safe harbor” can take many forms, and DFPI considered different proposals through the rulemaking process. For example, DFPI considered the issue of a “good faith” safe harbor during rulemaking and concluded:

The DFPI declines to adopt this change because the regulations already incorporate significant protections for providers. The DFPI can review the effectiveness of these protections after enactment of the regulations and reassess whether some kind of good faith safe harbor standard is appropriate.

As always, the Legislature is free to provide DFPI additional direction on how to proceed with regards to a safe harbor, and the author may wish to consider this further. However, a safe harbor must be carefully crafted so that it does not unintentionally allow a provider to purposely mislead a small business. SB 33 has also been referred to the Assembly Judiciary Committee, which is the committee best suited to review issues around liability.

6) Support

The California Association of Micro Enterprise Opportunity (CAMEO), the Responsible Business Lending Coalition (RBLC), and a coalition of organizations including consumer groups, local chambers of commerce, and development corporations, support SB 33 and the removal of the sunset. Their letter argues:

Continuing the disclosures is important because small business owners, especially first-time entrepreneurs, have little access to traditional bank loans. Many of these small business owners have a limited understanding of financial practices and do not have access to an attorney or accountant. They do not understand interest rates, prepayment penalties, or other complicated financing terms of the options that are available today. Moreover, many of the terms are not clearly written or proposed to the small business owner promptly. An incomplete understanding of the product can lead small business owners to borrow more than they can afford to repay or trap them in cycles of high-cost debt. An inappropriate financing product can lead a small business to financial ruin, or even worse, closure of the business.

7) Opposition

Organizations representing commercial finance providers oppose SB 33, citing potential litigation risks and the inappropriateness of APR for certain commercial financing products.

Moreover, Secured Finance Network (SFN) and the Small Business Finance Association (SBFA) separately oppose the bill unless amended. SFN requests amendments that, in their totality, remove the “Estimated APR” requirement for a subset of commercial finance providers. SFN argues:

Unfortunately, after numerous rounds of draft regulations, DFPI has adopted regulations that force our lenders to disclose an Annual Percentage Rate (APR) that imposes a consumer construct on a revolving commercial product that is inaccurate in this application. Because of this, a recent poll of our members found that 40% of those who responded intend to stop lending to small businesses in California. These lenders are afraid of facing both civil and criminal penalties because they cannot accurately disclose an APR when the outstanding balance and costs associated with the financing are constantly changing

SBFA shares similar concerns:

We request that SB 33 be amended to remove the requirement for an annualized metric and to give DFPI more flexibility and the opportunity to better examine the best, most meaningful way to provide disclosures across both loan and non-loan financing products. Removing this requirement is more consistent with consumer finance disclosure law (e.g., different disclosure requirements for loans and leases) and provides flexibility to the DFPI to review, study, and update disclosure requirements.

## **REGISTERED SUPPORT / OPPOSITION:**

### **Support**

Access Plus Capital  
Accessity  
Accion Opportunity Fund  
Agriculture & Land Based Training Association  
Ampac Tri-state CDC  
Anchor Capitol  
Anew America Community Corporation  
Asian Pacific Islander Small Business Program Wbc Ltsc Community Development Corp.  
Bankers Small Business CDC Of California  
Bay Area Development Company  
Bethel LA Cdc  
California Asset Building Coalition  
California Black Chamber of Commerce  
California Capital Financial Development Corporation  
California Hispanic Chamber of Commerce  
California Low-income Consumer Coalition  
California Reinvestment Coalition  
California Small Business Development Center (SBDC) - Valley Community  
Cameo - California Association for Micro Enterprise Opportunity  
Consumer Advocates Against Reverse Mortgage Abuse  
Consumer Federation of California  
Cook Alliance



Crowdfundbetter  
Economic Development and Financing Corporation  
El Pajaro Community Development Corporation  
Fresno Area Hispanic Foundation  
Fresno Metro Black Chamber of Commerce  
Funding Circle  
Go Local Sonoma County  
Greater Ontario Business Council  
Greenlining Institute  
Halo Business Finance Corp  
Inclusive Action for The City  
Inner City Advisor Fund Good Jobs  
International Rescue Committee  
Invest in Women Entrepreneurs Initiative  
Jefferson Economic Development Institute (JEDI)  
Latino Economic Development Center (LEDC)  
Lendingclub  
Lighter Capital  
Main Street Launch  
Marian Doub Consulting  
Maximum Reach for Economic Equity (fka Sac Black Biz)  
Mission Economic Development Agency (MEDA)  
Momentum Capital  
Multifunding  
Oakland African American Chamber of Commerce  
Oakland Citizens Committee for Urban Renewal (OCCUR)  
Pacific Community Ventures  
Prospera Community Development  
Public Law Center  
Renaissance Entrepreneurship Center  
Richmond Main Street Initiative  
San Francisco African American Chamber of Commerce  
San Mateo Area Chamber of Commerce  
Silver Lining Strategies & Advocacy  
Small Business California  
Small Business Majority  
Southeast Asian Community Center  
Start Small Think Big  
Start Up Monterey Bay  
The Crane Works  
The Responsible Business Lending Coalition  
Wadeco  
Women's Economic Ventures  
Woodstock Institute  
Working Solutions

**Oppose**

Abate-a-weed  
Asian Food Trade Association  
Asian Industry Business to Business  
AT Industrial Products  
Brea Chamber of Commerce  
Coalition of Small & Disabled Veteran Business Owners  
Courier-messenger INC.  
Crisp Catering  
Cypress Chamber of Commerce  
Flasher Barricade Association  
Maloney Meat Company  
Revenue Based Finance Coalition  
Seabreeze Books & Charts  
Sensis INC.  
Slavic-american Chamber of Commerce  
Social Hydraulics  
STAR Milling Co.

**Oppose Unless Amended**

Secured Financial Network  
Small Business Finance Association

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