

Date of Hearing: July 1, 2024

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Timothy Grayson, Chair

SB 1482 (Glazer) – As Amended June 25, 2024

SENATE VOTE: 39-0

SUBJECT: Commercial financing

SUMMARY: Establishes a registration program under the California Consumer Financial Protection Law (CCFPL) for persons offering commercial financing or commercial financing brokerage services to California residents.

Specifically, **this bill:**

- 1) Makes the following definitions:
 - a) “Applicant” means any person who applies for registration under the CCFPL.
 - b) “Commercial financing” has the same meaning as defined in Financial Code Section 22800
 - c) “Commercial financing transaction” means a consummated commercial financing transaction for which a disclosure is provided in accordance with subsection (a) of Section 920 of Title 10 of the California Code of Regulations.
 - d) “Recipient” means a small business whose activities are principally directed or managed in California.
 - e) “Small business” means a business entity organized for profit with annual gross receipts of no more than \$16 million or the level as biennially adjusted by the Department of General Services, as specified.
- 2) Prohibits a person from engaging in the business of offering to provide or providing commercial financing transactions or commercial financing brokerage services without first registering with the Department of Financial Protection and Innovation (DFPI).
- 3) Provides highly specified processes and procedures related to how DFPI shall administer the registration program and related requirements for applicants and registrants, including specified information that applicants must provide in the application for registration and how that information shall be provided.
- 4) Requires an applicant to provide a detailed description of the applicant’s business activities, including a description of all products or services offered or provided to California residents; a detailed schedule of charges associated with the products and services provided to California residents; and a description of how the applicant markets to California residents.

- 5) Requires a registrant to pay an initial application fee of \$350 and an annual registration fee of \$100 plus an assessment equal to its pro rata share of all costs and expenses reasonably incurred in the administration of the CCFPL, as specified.
- 6) Authorizes DFPI to revoke a registration if a registrant fails to pay a required assessment or fails to file a required annual report.
- 7) Prohibits a commercial financing provider or commercial financing broker from the following:
 - a) Taking a confession of judgment or any power of attorney at any time before a default by a recipient under the terms of a commercial financing transaction agreement or contract.
 - b) Including a provision in a commercial financing transaction agreement or contract that authorizes a commercial financing provider or commercial financing broker to attach or garnish any of a recipient's money held in an account in a depository institution.

EXISTING LAW:

- 1) Pursuant to the California Financing Law (CFL), requires the licensure and oversight by DFPI of businesses that provide commercial loans in the state. (Division 9 of the Financial Code, Section 22000 et seq.)
- 2) Pursuant to Division 9.5 of the Financial Code, commencing with Section 22800:
 - a) Requires specified disclosures related to commercial financing, which includes, among other things, a requirement to disclose the annualized rate for a commercial financing offer presented to a recipient. (Financial Code Section 22802 and 22803)
 - b) Defines "commercial financing" to mean 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 Section 22800(d))
- 3) Pursuant to the CCFPL and its implementing regulations:
 - a) Authorizes DFPI to prescribe rules regarding registration requirements applicable to a covered person engaged in the business of offering or providing a consumer financial product or service, as specified. (Financial Code Section 90009(a))
 - b) Authorizes DFPI to promulgate regulations that define unfair, deceptive, and abusive acts and practices in connection with the offering or provision of commercial financing to small business recipients, nonprofits, and family farms. (Financial Code Section 90009(e))
 - c) Pursuant to (b), provides rules governing commercial financing products and services, including the following:

- i) Defines “covered entity” to mean a small business, nonprofit, or family farm whose activities are principally directed or managed from California. (Title 10 California Code of Regulations, Section 1060(d))
 - ii) Defines “covered provider” to mean any person engaged in the business of offering or providing commercial financing or another financial product or service to a covered entity, unless that person is exempt from the CCFPL pursuant to Financial Code Section 90002. (Title 10 California Code of Regulations, Section 1060(e))
 - iii) Defines “small business” to mean a business entity organized for profit with annual gross receipts of no more than \$16,000,000 or the annual gross receipt level as biennially adjusted by the Department of General Services in accordance with Government Code section 14837, subdivision (d)(3), whichever is greater. (Title 10 California Code of Regulations, Section 1060 (i))
 - iv) Provides that is unlawful for a covered provider to engage or have engaged in any unfair, deceptive, or abusive act or practice in connection with the offering or provision of commercial financing or another financial product or service to a covered entity. (Title 10 California Code of Regulations, Section 1061(a))
- d) Authorizes DFPI to conduct examinations on a periodic basis of a registrant for the purposes of assessing compliance with consumer financial laws, obtaining information about the activities and compliance systems or procedures of the registrant, and detecting and assessing risks to consumers, small business, and to markets for consumer financial products and services. (Financial Code Section 90010)

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

COMMENTS:

1) Purpose.

According to the author:

Small business borrowers are increasingly seeking out alternative forms of financing to start or grow their businesses. These alternative forms of financing operate with very little oversight and regulation, exposing small business borrowers to exploitation from providers as well as brokers. Though these new forms of financing are important tools for those who need them, the lack of regulation limits borrower protections against unethical practices.

Additionally, financial providers may sign small business borrowers into egregious contracts with clauses like a confession of judgment. This allows providers to take money from a small business without recourse or due process. Some commercial finance brokers engage in steering practices where they exclusively refer small business borrowers to high-risk-high-cost providers that pay the broker up to 15% commission, over lower-cost financing that pay brokers less.

SB 1482 will curb exploitative actions by requiring commercial finance providers and brokers to register with the Department of Financial Protection and Innovation. Registration will give the Department the ability to know who is providing their services to small business borrowers, eliminating the black hole that currently exists in the commercial financing space. The bill will provide small business borrowers with protections such as prohibiting confessions of judgment and confidentiality clauses. SB 1482 is crucial in setting the foundation for much needed protections to prevent the abuse and exploitation of small businesses.

2) Background: Commercial financing

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. Some – but not all – options now include:

- 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.
- 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.

3) How are commercial financing providers regulated in California?

Commercial financing providers can be bank or nonbank companies offering a range of products, including loans covered by existing licensing programs. For example, the CFL requires licensure of companies offering either consumer or commercial loans. However, in practice the CFL does not apply to much of the commercial financing available today: the CFL does not apply to banks, credit unions, or other depository institutions, and a nonbank company exclusively offering non-loan products such as merchant cash advance may not need to obtain a CFL license.

Because much of the innovation in the commercial financing space has occurred outside the scope of DFPI's authority, policymakers traditionally have not focused on small business lending issues. But, in the mid-to-late 2010s, the surge of new companies offering online commercial loans or other forms of credit led to news reports and testimonials on the mistreatment of small business borrowers. Advocacy groups representing small businesses and "responsible lenders" developed materials such as a Small Business Bill of Rights, which outlines the rights that business owners seeking financing deserve, such as transparent pricing, non-abusive products, responsible underwriting, and fair treatment from brokers.¹

In response to the above-mentioned concerns, the Legislature passed SB 1235 (Glazer), Chapter 1011, Statutes of 2018, to require standardized commercial financing disclosures as well as SB 666 (Min), Chapter 881, Statutes of 2023, to eliminate certain junk fees from commercial financing transactions. These legislative efforts, which apply to both unlicensed companies and CFL licensees, aim to help small business borrowers compare and evaluate financing options and avoid unnecessary or surprise fees and expenses.

4) Background: Commercial financing brokers

This bill, among its many provisions, contemplates the role of brokers in the small business financing market. Individual brokers help locate businesses in need of funds and connect them to financiers. For alternative financing products like merchant cash advances, brokering can be lucrative. According to a 2014 Bloomberg article, these activities can retrieve commissions as high as 17% on the financed amount, far higher than the commissions earned on traditional small business loans backed by the Small Business Administration.²

Brokers can play an essential role in connecting lenders to potential customers, and vice versa. However, loan brokers are often scrutinized for steering borrowers into financing that works for the broker's commission but not the business. Brokers can also be aggressive and use harassment to push business owners into ill-fitting or costly financing agreements. For instance, Federal Trade Commission enforcement actions against merchant cash advance providers highlight how certain providers use a large network of brokers who engage in deceptive and unfair practices.³

It is also unclear the depth of financing providers' broker networks and whether the providers have a firm understanding of who is working on their behalf. Committee staff was unable to

¹ <http://www.borrowersbillofrights.org/>

² <https://www.bloomberg.com/news/articles/2014-04-03/alternative-lenders-still-rely-on-loan-brokers>

³ <https://www.ftc.gov/news-events/news/press-releases/2022/01/merchant-cash-advance-providers-banned-industry-ordered-redress-small-businesses>

find good data about the number of brokers or their commission structures, though news articles and enforcement actions, like the ones mentioned above, suggest that the market is varied and chaotic. For instance, some “good actor” brokers offer a variety of financing options that can be tailored to the small business owner’s needs, while other brokers exclusively push merchant cash advances and high-rate financing.

5) Background: The CCFPL registration process.

In 2020, the Legislature passed AB 1864 (Limón), Chapter 157, which established the California Consumer Financial Protection Law (CCFPL) to identify and fill gaps in consumer protection. Because state oversight of financial services generally relies on licensing programs built around strict definitions of products or services, new or emerging financial products may not fit neatly into one of DFPI’s many existing programs. The CCFPL is meant to act as a type of wraparound authority that DFPI can use to oversee unlicensed providers of consumer financial products or services.

The CCFPL registration process is the primary tool that DFPI will use to carry out its new consumer protection authority. The registration process works like this: DFPI first identifies a consumer financial product or service that merits registration, and then DFPI promulgates regulations to establish that registration requirement, the details of which are guided by information DFPI received from an initial Invitation for Comment. Another unique feature of the CCFPL registration process is that any required registration lasts only four years following the year it begins. After that, the Legislature can extend the registration, let it lapse, or use the data and information collected by DFPI to inform changes to state law.

DFPI has yet to finalize its first round of registrations. That first round, proposed in 2023 and currently pending with the Office of Administrative Law (OAL) for final approval, would register providers of earned wage access, private postsecondary education financing, debt settlement, and student debt relief.

Though DFPI has not yet started a CCFPL registration program, it has finalized other regulations related to its enforcement authority over certain commercial financing providers. This package of regulations is meant to empower DFPI to protect businesses against unlawful, unfair, deceptive, or abusive acts and practices and clarifies what such practices would be in connection with small business financing. The rule also requires small business financing providers to annually report to DFPI about their activities.

6) What does SB 1482 do?

SB 1482, as amended on May 16, 2024, is much different than prior iterations of the bill. As originally introduced, SB 1482 would have required commercial financing providers and brokers to obtain a CFL license and would have established a range of new protections for small business financing recipients. Because the CFL does not cover all forms of business financing, SB 1482 would have been a significant expansion of the program.

The author’s original approach was reasonable, but it also presented operational and cost challenges for DFPI. As the Senate Appropriations Committee noted in its analysis, SB 1482’s expansion of the CFL to cover non-loan commercial financing as well as brokers

would have led to possibly hundreds of new applications, resulting in significant costs to the department related to application processing and ongoing examinations.

SB 1482 was amended by the Senate Appropriations Committee with author amendments that replaced the original CFL licensure requirements with a CCFPL registration requirement. Many of SB 1482's provisions match the details of the regulations described in Comment #5. In effect, SB 1482 would jumpstart DFPI's normal (and lengthy) CCFPL registration process by statutorily requiring these companies to register with the department.

There are four main components to SB 1482:

- Registration requirement: Commercial financing providers and brokers must register with DFPI for their "subject products," which includes either commercial financing transactions or commercial financing brokerage services that meet certain criteria. For example, a commercial financing transaction is a "subject product" if it is \$500,000 or less and the recipient is a small business located in California with less than \$16 million of annual revenue.
- Program administration: SB 1482 incorporates many of the administrative requirements specified in pending DFPI registration rules, including the use of the National Mortgage License System (NMLS) application process and other details, such as the email address applicants must use to apply for registration.
- Information collection: Registrants must provide DFPI specified information during the application process, such as the key individuals running the company and a description of all products or services offered to California residents and their associated charges. Moreover, as part of an annual report, a registrant must report the gross income from the "subject products."
- Standalone obligations on providers. In provisions set outside the registration program, SB 1482 contains the following:
 - A prohibition on a commercial finance provider or broker taking a confession of judgment or any power of attorney at any time before a default by a recipient under the terms of a commercial financing transaction agreement or contract. According to the author's office, some small financing providers employ abusive practices such as a "confession of judgment" clause that allows them to take any amount of money they feel entitled to without going through a legal process to assess a just quantity.
 - Including a provision in a commercial financing transaction agreement or contract that authorizes a commercial financing provider or commercial financing broker to attach or garnish any of a recipient's money held in an account in a depository institution.
 - A prohibition against including a provision in a contract or agreement with a recipient that limits or restricts the recipient from disclosing information that the recipient gains from the recipient's business activities with the registrant, including, but not limited to, terms or conditions of a product or service offered by the registrants. The author's office note that some financing contracts try to prevent small business

owners from telling outside parties about the costs of the financing through “confidentiality clauses,” and SB 1482 would prohibit such clauses.

7) Recent author amendments.

The author recently amended SB 1482 in response to requests from industry stakeholders. Amendments include an additional bill section that incorporates the exemptions from the CFL, including for depository institutions, floor plan lenders, and those making a de minimum number of commercial financing transactions, as well as clarifying amendments suggested by the Revenue Based Finance Coalition.

8) Staff comments and remaining questions.

SB 1482 would undoubtedly help California oversee the small business lending sector and inform future policymaking related to commercial financing and brokering. Legislative efforts to rein in unscrupulous small business lenders have not been driven by white papers, academic reviews, or market analyses. Instead, these efforts have been driven by advocacy coalitions comprised of small businesses that interface with these companies, use their financing products, and experience firsthand the harm coming from an unregulated financing industry. Despite all the work in this area in California and other states, the “alternative” small business lending market remains a bit mysterious, and SB 1482 would demystify these financing products and use the CCFPL registration process as it was intended.

Some of SB 1482’s reporting requirements are likely to be burdensome for applicants, but this is due in large part to the complexity of the industry. For example, SB 1482 requires a registrant to report a “detailed schedule of the charges associated with the products and services provided to California residents including, but not limited to, subject products. Where charges vary based upon the type of the transaction or other factors, the applicant shall provide a description of how charges are set or determined.” Industry stakeholders have noted this reporting would be cumbersome and time-consuming because of the many combinations of specific financing products and the calculation of fees and charges. However, just because a product is complicated, it does not mean the state of California should not understand how it works. The complexity of some of these financing products is itself a source of harm, and it is fair to ask companies to explain how they work, how they make money, and what their customers pay.

However, there remain serious and unanswered questions about the implementation of SB 1482 and DFPI’s workload. The author’s office has indicated that it is seeking input and technical assistance from DFPI about some of SB 1482’s provisions and the impact on DFPI’s workload. If the bill moves forward, the author’s office has committed to informing the committee of the outcome of those discussions. Remaining concerns include:

- Will DFPI need to add more specificity about who must register? The murkiness around how commercial financing is regulated under the CFL may require DFPI to add more specificity about which products are under the CFL and which are not, and this may need to be done before moving forward with registration. This may mean that DFPI would still need to promulgate regulations to implement SB 1482, which would delay implementation.

- What will be DFPI's workload? While the current version of this bill is a much lighter lift than the earlier version's proposed licensing, SB 1482 would still be a large undertaking. The full scope of affected companies is unknown, as is the impact on DFPI's bandwidth.
- Should the registration program sunset? Unlike CCFPL registration initiated by the department, SB 1482's program does not have an end date or sunset. At a certain point, the information gathering from CCFPL registration stops being helpful, and SB 1482 may eventually settle into a program consisting of mostly a lot of paperwork for all parties involved. The author may wish to consider adding a sunset to align this registration with how the CCFPL typically works, so that the Legislature must come back and incorporate the registration program's findings into an existing or new law.

9) Support

A coalition of organizations representing for-profit financing companies and nonprofit advocates for economic advocates write in support of SB 1482. Their letter states:

Over the last fifteen years, practices from the pre-crisis subprime mortgage market have become common in small business financing. SB 1482 plugs holes in California's legal framework that are allowing some brokers and financing companies to take advantage of small businesses. While these activities are currently unregulated, it would require brokers and non-loan small business financing providers to register with DFPI. We urge you to pass this bill to create a fair financial marketplace where good actors compete fairly, and small businesses thrive.

SB 1482 will help address two problems:

- 1) **The "wild west" of small business brokering** – Small businesses today are routinely "steered" by brokers into financing that pays the broker the highest fee while charging the small business an unnecessarily high rate. This behavior by brokers echoes one of the causes of the subprime mortgage crisis. In fact, investigative reports have shown that many subprime mortgage brokers who lost their mortgage licenses simply moved over to the unregulated "wild west" of small business financing.¹

SB 1482 provides a basic level of oversight over small business brokers by establishing a registration framework. Once DFPI is given information about what brokers are operating in California, it will be able to provide some protection to small businesses who are mistreated.

- 2) **Unfair financing practices in the shadows** - While small business lenders are subject to licensing and oversight by DFPI, similar products that purport not to be loans evade these requirements and operate in the shadows. Additionally, CA's 2022 ban on "confessions of judgement" (SB 688) is being circumvented by functionally equivalent legal devices used to take money straight from small businesses bank accounts without legal recourse. And "confidentially clauses" are being used to bully small businesses into keeping silent after they are victimized.

SB 1482 will catalyze good lending to small businesses by preventing bad-actor financing companies from taking unfair advantage of their competition, and of small business customers

10) Oppose

The Revenue Based Finance Coalition writes in opposition, arguing:

Our concerns stem from the practical application from (1) an overbroad paperwork collection and submission process on the part of the provider that exceeds the registration requirements of any other state and (2) a costly document review process by DFPI for nearly all unlicensed non-bank providers of commercial financing in the state of California. The scope of the proposed registration requirement is vast including equipment leasing, sales-based financing, and invoice factoring. As written, the amount of information that DFPI will receive from the ecosystem of registered providers in the state will be staggering. Reducing the complexity of registration will reduce costs to the state of California.

REGISTERED SUPPORT / OPPOSITION:

Support

Access Plus Capital
Asian, INC.
California Coalition for Community Investment
California Low-income Consumer Coalition
Cameo - California Association for Micro Enterprise Opportunity
Consumer Federation of California
El Pajaro Community Development Corporation
Lendistry
Microenterprise Collaborative of Inland Southern California
National Community Reinvestment Coalition
Pacific Community Ventures
Public Counsel
Renaissance Entrepreneurship Center
Rise Economy
Sacramento Hispanic Chamber of Commerce
Small Business Majority
The Greenlining Institute
The Responsible Business Lending Coalition
UC Berkeley Law - New Business Community Law Clinic
Uptima Entrepreneur Cooperative

Oppose Unless Amended

Electronic Transactions Association
Forward Financing, LLC
Revenue Based Finance Coalition

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