

**SENATE JUDICIARY COMMITTEE**  
**Senator Thomas Umberg, Chair**  
**2023-2024 Regular Session**

SB 33 (Glazer)  
Version: December 5, 2022  
Hearing Date: April 11, 2023  
Fiscal: Yes  
Urgency: No  
AWM

**SUBJECT**

Commercial financing: disclosures

**DIGEST**

This bill removes the January 1, 2024, sunset provision that applies to a disclosure requirement of the cost of a commercial financing transaction expressed as an annualized rate.

**EXECUTIVE SUMMARY**

In 2018, the Legislature enacted SB 1235 (Glazer, Ch. 1011, Stats. 2018), which established required disclosures for commercial financing offers of under \$500,000, as specified. The bill was intended to provide small business owners with information about the actual cost of financing.

One portion of SB 1235, which was intended to provide borrowers with the total cost of the loan, went through several iterations and was the source of significant contention. The bill ultimately charged the Department of Financial Protection and Innovation (DFPI) with establishing, through regulations, the specific method by which a commercial lender would be required to disclose the total cost of financing as expressed in an annualized rate. SB 1235 provided that this specific disclosure metric would sunset on January 1, 2024, leaving the remainder of the bill intact, and that the disclosure requirements as a whole would not take effect until the regulations took effect. DFPI, after an extensive rulemaking process, opted to require the disclosure of the annual percentage rate (APR) or estimated APR of the loan. The regulations took effect December 9, 2022.

This bill removes the sunset on the requirement that disclosures relating to small commercial financing offers include the total cost of financing as expressed in an annualized rate, in the form determined by the DFPI.

This bill is sponsored by the author and supported by over 60 organizations representing small business owners and groups dedicated to encouraging economic development. This bill is opposed by the Revenue Based Finance Coalition. This bill was passed out of the Senate Banking and Financial Institutions Committee with a vote of 6-0.

### **PROPOSED CHANGES TO THE LAW**

Existing law:

- 1) Establishes the California Financing Law (CFL), which regulates specified finance lenders and brokers making certain types of commercial loans. (Fin. Code, div. 9, §§ 22000 et seq.)
- 2) Establishes, separate from the CFL, disclosure requirements for certain small commercial loans, subject to the terms and exemptions set forth in 3)-x). (Fin. Code, div. 9.5, §§ 22800 et seq.)
- 3) Requires a commercial financing provider to disclose specified information to a loan recipient, at the time the provider extends a specific commercial financing offer to that recipient, and to obtain the recipient's signature on such disclosure before consummating the commercial financing transaction. The information to be disclosed is as follows:
  - a) The total amount of funds provided; the total dollar cost of the financing; the term or estimated term; the method, frequency, and amount of payments; a description of prepayment policies; and the total cost of financing expressed as an annualized rate. (Fin. Code, § 22802(a), (b).)
  - b) If the provider of commercial financing offers commercial financing that is factoring or asset-based lending and that offers the recipient an agreement that describes the general terms and conditions of the commercial financing transaction that will occur under the agreement, the provider may disclose the following in lieu of 3)(a): an amount financed; the total dollar cost; the term or estimated term; the method, frequency, and amount of payments; a description of prepayment policies; and the total cost of the financing expressed as an annualized rate. (Fin. Code, § 22803(a).)
- 4) Requires the Commissioner of the DFPI to adopt regulations to govern the disclosures in 3), as specified. (Fin. Code, § 22804(a), (b).)
- 5) Provides that a provider shall not be required to comply with 3) until the final regulations are adopted pursuant to 4) and become effective, as specified. (Fin. Code, § 22804(c).)

- 6) Provides that, after the final regulations have become effective under 4), any provider required to make the disclosures shall be subject to examination and enforcement by the Commissioner of the DFPI pursuant to provisions under the California Financing Law. (Fin. Code, § 22805.)
- 7) Provides that the requirement to disclose the total cost of financing expressed as an annualized rate under 3) will sunset on January 1, 2024. (Fin. Code, §§ 22802(c), 22803(b).)
- 8) Exempts from the disclosure requirement in 3) all of the following:
  - a) Depository institutions.
  - b) Lenders regulated under the federal Farm Credit Act (12 U.S.C. §§ 2001 et seq.).
  - 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. (Fin. Code, § 22801.)
- 9) Defines relevant terms for purposes of 2), including:
  - a) "Commercial financing" is an accounts receivable purchase transaction, including factoring, asset-based lending transaction, commercial loan, commercial open-ended credit plan, or lease financing transaction intended by the recipient for use primarily for other than personal, family, or household purposes. For purposes of determining whether financing is commercial financing, the provider may rely on any written statement of intended purposes signed by the recipient, which may be contained in the loan application or in a separate statement. The provider shall not be required to ascertain that the proceeds of the commercial financing are used in accordance with the statement of intended purposes.
  - b) "Commercial loan" is a loan of a principal amount of \$5,000 or more, or any loan under an open-end credit plan, the proceeds of which are intended by the recipient for use primarily for other than personal, family, or household purposes.
  - c) "Commissioner" is the Commissioner of the DFPI.
  - d) "Depository institution" is (1) a bank, trust company, or industrial loan company doing business under the authority of, or in accordance with, specified state or federal processes; (2) a federally chartered savings and loan

- association, federal savings bank, or federal credit union that is authorized to transact business in this state; or (3) a savings and loan association, savings bank, or credit union organized under the laws of this or any other state; additionally, any of the institutions in (1)-(3) must be authorized to do business in this state.
- e) "Provider" is a person who extends a specific offer of commercial financing to a recipient, as well as a nondepository institution which enters into a written agreement with a depository institution to arrange for the extension of commercial financing by the depository institution to a recipient via an online lending platform administered by the nondepository institution. The fact that a provider extends a specific offer of commercial financing or lending on behalf of a depository institution does not mean that the provider engaged in lending or originated that loan or financing.
  - f) "Recipient" means a person who is presented a specific financing offer by a provider that is equal to or less than \$500,000. (Fin. Code, § 22800.)

This bill:

- 1) Eliminates the sunset on the requirements to disclose the total cost of financing expressed as an annualized rate.

### COMMENTS

#### 1. Author's comment

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 consumer protection priorities and the adoption of disclosure requirements for small business financing offers

Consumer protection in the banking and finance sector is a priority for this state. The California Financing Law (CFL) sets forth a comprehensive regulatory framework for consumer and commercial loans issued by specified financial institutions.<sup>1</sup> The CFL's goals include permitting and encouraging the development of economically sound lending practices and protecting borrowers against unfair practices by some lenders, and its provisions should be liberally construed to promote its purposes and policies.<sup>2</sup>

With the advent of different types of commercial financing, however, not all commercial lending entities are covered by the CFL. This left a gap in the CFL's protective framework for commercial lending. In response, the Legislature enacted SB 1235 (Glazer, Ch. 1011, Stats. 2018), which established disclosure requirements for specified entities extending commercial financing offers of less than \$500,000. SB 1235 deliberately placed its disclosure requirements outside of the CFL to ensure that it covered all commercial lenders, except those already covered by other specified disclosure laws.<sup>3</sup> The bill's disclosure requirements are intended to help small businesses understand the terms of commercial financing being offered to them. The Senate Banking and Financial Institution Committee's analysis of this bill discusses the types of financing covered by this bill; it is incorporated herein by reference.

## 3. The history of the "the total cost of the financing expressed in an annualized rate" disclosure requirement addressed in this bill

SB 1235 went through several iterations before its final passage. When this Committee heard the bill, stakeholders objected to the bill's required disclosure of a financial product's APR.<sup>4</sup> To address those concerns, the author proposed deleting the APR disclosure and instead requiring covered providers to disclose the "estimated annualized cost of capital (ACC)," a figure calculated using a formula set forth in the bill.<sup>5</sup> Stakeholders were mixed on the ACC proposal, with some concerned that the

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<sup>1</sup> Fin. Code, div. 9, §§ 22000 et seq.

<sup>2</sup> *Id.*, § 22001.

<sup>3</sup> Sen. Comm. on Banking & Financial Institutions on Sen. Bill No. 1235 (2017-2018 Reg. Sess.) Aug. 31, 2018, p. 7; Fin. Code, § 228801.

<sup>4</sup> Sen. Comm. on Judiciary on Sen. Bill No. 1235 (2017-2018 Reg. Sess.) May 7, 2018, pp. 8-9.

<sup>5</sup> *Id.* at pp. 9-12.

metric was untested and could confuse businesses by potentially representing the costs of their products.<sup>6</sup> The bill was nevertheless amended to delete the APR disclosure and add the ACC disclosure as it was voted out of this Committee.<sup>7</sup> Those amendments also introduced a sunset provision for the first time, providing that the ACC disclosure provision would sunset on January 1, 2023.<sup>8</sup>

As the bill wound its way through the Assembly, the author amended several provisions of the bill, including – in response to stakeholder concerns – removing the ACC disclosure requirement.<sup>9</sup> Rather than go back to requiring disclosure of the APR – which stakeholders still objected to – the author chose a third option, which was ultimately codified: the Commissioner of the DFPI (then the Department of Business Oversight) would be required to select an appropriate method to express the total cost of the financing expressed in an annualized rate and establish that rate through regulations.<sup>10</sup> The same amendments modified the sunset to have it apply only to the annualized rate disclosure requirement, and – because the potentially problematic ACC metric was no longer in the bill – extended the sunset until January 1, 2024.<sup>11</sup>

At the end of 2022, the DFPI enacted its regulations pursuant to SB 1235. Under its mandate to select a metric for the disclosure of the total cost of financing expressed in an annualized rate, the DFPI engaged in a four-year rulemaking process to determine the best metric. Ultimately, DFPI elected to require the disclosure of APR or, for financing options that do not assume a set monthly payment, the estimated APR.<sup>12</sup> The estimated APR may be calculated in ones of two ways: the historical method, which allows the lender to calculate the recipient’s future monthly sales by relying on the borrower’s historical sales, as specified;<sup>13</sup> and the underwriting method, which allows the lender to make assumptions about the borrower’s sales based on the best information available at the time and requires the lender to periodically audit its assumptions to determine whether it needs to modify its method.<sup>14</sup>

The regulations became effective on December 9, 2022.<sup>15</sup> Accordingly, even though SB 1235 has been law since the beginning of 2019, its disclosure requirements have been effective for fewer than six months.

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<sup>6</sup> *Id.* at pp. 11-12.

<sup>7</sup> See SB 1235 (Glazer, 2018), May 10, 2018, version.

<sup>8</sup> *Ibid.*

<sup>9</sup> See Assem. Comm. on Approps. on Sen. Bill No. 1235 (2017-2018 Reg. Sess.) Aug. 24, 2018, p. 2.

<sup>10</sup> *Ibid.*; see Fin. Code, §§ 22082(b)(6), 22083(f), 22804.

<sup>11</sup> See SB 1235 (Glazer, 2018), Aug. 16, 2018, version.

<sup>12</sup> See Cal. Code Regs., tit. 10, §§ 901, 910-917.

<sup>13</sup> *Id.*, § 930.

<sup>14</sup> *Id.*, § 931.

<sup>15</sup> See *id.*, tit. 10, ch. 3., subch. 3, §§ 900 et seq.

3. This bill removes the sunset on the “the total cost of financing expressed in an annualized rate” disclosure requirement

This bill removes the January 1, 2024, sunset on the provision requiring the disclosure of the total cost of financing as expressed in an annualized rate – currently APR or estimated APR pursuant to DFPI regulations.

The bill’s supporters argue that the annualized rate disclosure requirement provides important information to small business owners, many of whom are financially unsophisticated and do not have access to an attorney or accountant. They note that there is a wide range of financing options available to small businesses, many of which do not resemble stereotypical bank loans and which can have annualized rates approaching 100 percent. Without the all of the disclosures required in SB 1235, they argue, small business owners might not have a complete picture of the financing terms they are agreeing to and will end up overpaying more than they can afford.

The Revenue-Based Finance Coalition, writing in opposition, argues that the DFPI’s “estimated APR” metric is not useful, particularly with respect to revenue-based financing, because it requires the lender to estimate payments based on assumptions that might end up being incorrect. Revenue-based financing sets loan repayments as a portion of the borrower’s revenues, e.g., some percentage of the borrower’s monthly revenues; as such, to determine the estimated APR, the lender has to draw up a repayment schedule based on its best guess of the borrower’s future revenues. These objections are similar to those made in opposition to SB 1235 and during the DFPI’s rulemaking process.

**SUPPORT**

Access Plus Capital

Accessity

Accion Opportunity Fund

Agriculture and Land-based Training Association

AmPac Tri-State CDC

Anchor Finance Services

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 Los Angeles Community Development Corporation

California Asset-Building Coalition

California Black Chamber of Commerce

California Capital Financial Development Corporation

California Hispanic Chambers of Commerce

California Low-Income Consumer Coalition  
California Reinvestment Coalition  
California Small Business Development Center – Valley Community  
California State University, Monterey Bay Institute for Innovation and Economic  
Development  
CAMEO  
Consumer Advocates Against Reverse Mortgage Abuse  
Consumer Federation of California  
Crowdfund Better  
Economic Development and Financing Corporation  
El Pajaro Community Development Corporation  
Fondo Adelante, Mission Economic Development Agency  
Fresno Area Hispanic Foundation  
Fresno Metro Black Chamber of Commerce  
Funding Circle  
Go Local Sonoma County  
Greater Ontario Business Council  
Halo Business Finance Corp.  
Inclusive Action for the City  
International Rescue Committee’s Center for Economic Opportunity  
Invest in Women Entrepreneurs Initiative  
Jefferson Economic Development Institute  
Latino Economic Development Center  
LendingClub  
Lighter Capital  
Main Street Launch  
Marian Doub Consulting  
Maximum Research for Economic Equity  
Microenterprise Collaborative of Inland Southern California  
Momentum Capital  
Multifunding  
Oakland African American Chamber of Commerce  
Oakland Citizens Committee for Urban Renewal  
Pacific Community Ventures  
Prospera Community Development  
Public Law Center  
Renaissance Entrepreneurship Center  
Responsible Business Lending Coalition  
Richmond Main Street Initiative  
San Francisco African American Chamber of Commerce  
San Mateo Area Chamber of Commerce  
Silver Lining  
Small Business California  
Small Business Majority



Southeast Asian Community Center  
Start Small Think Big  
The C.O.O.K. Alliance  
The CraneWorks  
Wadeco Business Center  
Women's Economic Ventures  
Woodstock Institute  
Working Solutions

### **OPPOSITION**

Revenue Based Finance Coalition

### **RELATED LEGISLATION**

Pending Legislation: SB 865 (Glazer, 2023) requires a person who provides commercial brokerage services to a borrower in a commercial loan transaction by soliciting lenders or otherwise negotiating a commercial loan, to be licensed by the Commissioner the DFPI and would impose a fiduciary responsibility to the borrower upon a person who provides commercial brokerage services in a commercial loan transaction by soliciting lenders or otherwise negotiating a commercial loan, as specified. SB 865 is pending before the Senate Banking and Financial Institutions Committee.

#### Prior Legislation:

SB 1235 (Glazer, Ch. 1011, Stats. 2018) enacted the provisions at issue in this bill. See Part 2 for further discussion of the bill's contents and history.

SB 984 (Hueso, Ch. 480, Stats. 2016) repealed the January 1, 2018, terminal date for the Pilot Program, and extended the Pilot Program until January 1, 2023.

SB 318 (Hill, Ch. 467, Stats. 2013) made changes to an existing installment loan pilot project authorized by SB 1146 (Florez, Ch. 640, Stats. 2010) intended to increase the availability of loans between \$300 and \$2500 to consumers and thereby provide a responsible market alternative to payday loans. The modified pilot project would, until January 1, 2018, permit lenders to charge higher interest rates, origination fees, and delinquency fees than are permitted under the CFLL in an effort to increase the availability of small-dollar loans and credit-building opportunities for unbanked or under-banked persons.

### **PRIOR VOTES:**

Senate Banking and Financial Institutions Committee (Ayes 6, Noes 0)

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