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

SB 869 (Glazer)
Version: January 3, 2024
Hearing Date: January 11, 2024
Fiscal: Yes
Urgency: No
AWM

SUBJECT

Commercial financing

DIGEST

This bill expands the California Financing Law (CFL) to include all types of commercial financing offered to small businesses; and adds new requirements for commercial financing providers and commercial financing brokers in commercial financing transactions with small businesses, as defined. These provisions will take effect January 1, 2026.

EXECUTIVE SUMMARY

The CFL regulates commercial and consumer loans in California. Its primary goals are to ensure an adequate supply of lending to borrowers in California, while protecting borrowers against unfair business practices. Currently, however, the CFL does not apply to non-loan financing products, which may include asset-based lending, accounts receivable purchase transactions, and open-ended credit plans. These forms of financing are often offered to businesses, particularly small businesses, that may not qualify for a traditional loan and which may be less financially sophisticated. The Legislature has taken steps in the last year to add disclosure requirements for, and eliminate "junk fees" charged in, all commercial financing transactions.[1]

This bill takes the significant step of expanding the CFL to apply to providers and brokers who engage in all types commercial financing transactions with small businesses—not just loans. First, the bill adds to the CFL's existing licensing and enforcement provisions commercial financing providers and commercial financing brokers who transact with small businesses. Second, the bill adds to the CFL specific additional requirements for the commercial financing providers and brokers when engaging in commercial financing transactions with small businesses; these added

[1] See SB 33 (Glazer, Stats. 2023); SB 666 (Min, Ch. 881, Stats. 2023).

requirements are intended to ensure that the small businesses who are engaging in financial transactions have the information they need to make sound financing decisions. The bill's new requirements will take effect January 1, 2026. The author has agreed to amendments proposed by the Senate Banking and Financial Institutions Committee that are intended to clarify the scope of the new requirements and delete obligations that were unlikely to benefit small businesses. Because of the timing, these amendments will be taken in the Senate Appropriations Committee.

This bill is sponsored by the author. This bill is opposed by Forward Financing, Kapitus, Rapid Finance, and the Small Business Finance Association. The Senate Banking and Financial Institutions Committee is scheduled to hear this bill on January 10, 2024, prior to this Committee's hearing.

PROPOSED CHANGES TO THE LAW

Existing law:

1) Establishes the CFL, which regulates consumer and commercial loans with the goals of ensuring an adequate supply of credit to borrowers in the state and protecting borrowers against unfair lending practices. (Fin. Code, div. 9, §§ 22000 et seq.)[2]

2) Defines terms within the CFL, including:
   a) "Broker," which includes any person who is engaged in the business of negotiating or performing any act as broker in connection with loans made by a finance lender. (Fin. Code, § 22204.)
   b) "Finance lender," which includes any person who is engaged in the business of making consumer or commercial loans; the business of making consumer or commercial loans may include lending money and taking, in the name of the lender, or in any other name, in whole or in part, as security for a loan, any contract or obligation involving the forfeiture of rights in or to personal property, the use and possession of which property is retained by other than the mortgagee or lender, or any lien on, assignment of, or power of attorney relative to wages, salary, earnings, income, or commission. This definition includes a personal property broker. (Fin. Code, § 22209.)
   c) "Charges," for purposes of a commercial loan, include the aggregate interest, fees, bonuses, commissions, brokerage, discounts, expenses, and other forms of costs charged, contracted for, or received by a licensee or any other person in connection with the investigating, arranging, negotiating, procuring, guaranteeing, making, servicing, collecting, and enforcing of a loan or forbearance of money, credit, goods, or things in action, or any other service

[2] The CFL and other financial regulations set forth herein exclude from their ambit institutions regulated other existing law, including depository institutions, institutions subject to certain federal regulations, and institutions that make only a small number of commercial financial transactions in the state each year. (*E.g.*, Fin. Code, §§ 22050, 22050.5, 22801; Civ. Code, § 1799.301.)

rendered; "charges" excludes commissions received by a licensed insurance agent or broker. (Fin. Code, §§ 22500, 22501.)

d) "Commercial loan" means a loan of a principal amount of $5,000 or more, or any loan under an open-end credit program, whether secured by either real or personal property, or both, or unsecured, the proceeds of which are intended by the borrower for use primarily for other than personal, family, or household purposes.
   i. For purposes of determining whether a loan is a commercial loan, the lender may rely on any written statement of intended purposes signed by the borrower. The statement may be a separate statement signed by the borrower or may be contained in a loan application or other document signed by the borrower. The lender shall not be required to ascertain that the proceeds of the loan are used in accordance with the statement of intended purposes. (Fin. Code, § 22502.)

3) Provides that no person shall engage in the business of a finance lender or broker without obtaining a license from the Commissioner of the DFPI. (Fin. Code, § 22100.)

4) Establishes requirements for a covered entity to apply for, and for the DFPI to issue, a license pursuant to 3). (Fin. Code, §§ 22101-22112.)

5) Authorizes the Commissioner of the DFPI to make general rules and regulations and specific rulings for the enforcement of the CFL, and sets forth various actions that are prohibited, or mandated, by a licensee. (Fin. Code, §§ 22151-22171.)
   a) Commercial lenders are exempt from certain requirements involving the lender's name and place of business, provided that the lender's activity is not for purposes of evading the CFL. (Fin. Code, § 22550.)

6) Authorizes the Commissioner of the DFPI to take various actions in response to a licensee in violation of the CFL, including taking action to deny, suspend, revoke, or decline to renew a license; imposing fines on a licensee; issuing corrective orders; or imposing a civil penalty after a hearing on the record in which the licensee was provided the opportunity to be heard. (Fin. Code, § 22172.)

7) Establishes specific regulations for commercial lenders and loans covered by the CFL, including the sale of promissory notes, payments made to unlicensed persons who make referrals to lenders, and open-ended credit programs. (Fin. Code, div. 9, ch. 3, arts. 3-4, §§ 22600-22650.)

8) In addition to the CFL, requires the providers of commercial financing—defined to include all commercial financing products, not just loans—to make specified disclosures in connection with commercial financing offers, including the total amount of funds provided, the total dollar cost of the financing, the term or

estimated term, and the total cost of financing expressed as an annualized rate. (Fin. Code, div. 9.5, §§ 22800 et seq.)

9) Prohibits a broker or provider of commercial financing from charging specified fees in a commercial financing transaction with a small business, as defined, including:
   a) A fee for accepting or processing a payment required by the terms of the commercial financing contract as an automated clearinghouse transfer debit, except where the transfer fails due to insufficient funds in the transferor's account.
   b) A fee for providing a small business with certain documentation regarding the amount due on the loan.
   c) A fee in addition to an origination fee that does not have a clear corresponding service for the fee.
   d) A fee for monitoring the small business's collateral, unless the underlying transaction is delinquent for more than 60 days.
   e) A fee for filing or terminating a lien filed in accordance with the provisions of the Uniform Commercial Code against the business's assets that exceeds 150 percent of the cost of the filing or termination. (Civ. Code, div. 3, pt. 4, tit. 1.90, §§ 179.300 et seq.)

This bill:

1) Requires commercial financing providers and commercial financing brokers that provide commercial financing to small businesses (collectively, CF providers and brokers) to be licensed under, and subject to, the CFL.

2) Defines, pursuant to 1), "commercial financing" as an accounts receivable purchase transaction, including factoring, asset-based lending transaction, commercial loan, or lease financing, intended by the recipient for use primarily for a purpose other than a personal, family, or household purpose.
   a) A "commercial financing broker" is a person who is engaged in the business of performing enumerated acts in connection with commercial financing made by a commercial financing provider, including relating to commercial financing referrals and participating in commercial financing negotiations, as specified.
   b) A "commercial financing provider" is a person who extends a specific offer of commercial financing to a recipient, including, but not limited to, a nondepository institution that 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 commercial financing provider extended a specific offer of commercial financing on behalf of a depository institution shall not be construed to mean that the commercial financing provider engaged in, or originated, that financing.

   c) A "recipient" is a small business or small business owner who is presented with a specific commercial financing offer by a commercial financing provider that is equal to or less than $500,000.

3) Adds, within the CFL, requirements for commercial financing made or offered to small businesses, including the below and 4)-13):
   a) A CF provider or broker shall not take a confession of judgment or any power of attorney at any time before a default by a small business recipient under the terms of the commercial financing transaction agreement or contract.
   b) A CF provider or broker shall not include a provision in a commercial financing transaction agreement or contract with a small business recipient that authorizes a CF provider or broker to attach or garnish any of a recipient's money held in an account in a depository institution.

4) Provides that a CF provider or broker shall not do any of the following:
   a) Take an instrument in which blanks are left to be filled in after execution.
   b) Include 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 CFL licensee.
   c) Violate existing prohibitions on charging certain fees in connection with a commercial financing transaction with a for small business, as set forth in Title 1.90 of Part 4 of Division 3 of the Civil Code.
   d) Collect a charge based on the source of the funds for the repayment of a commercial financing transaction.

5) Provides that a commercial financing provider providing commercial financing to a small business recipient must:
   a) Comply with the existing disclosure requirements for commercial financing set forth in Title 9.5 of the Commercial Code.
   b) Obtain from the small business recipient a signed statement regarding whether a broker or other person participated in the commercial financing transaction, and if so, obtain a full statement of all sums paid or payable to the broker or other person.
   c) Permit payment to be made in advance in any amount on any commercial financing transaction at any time.
   d) Deliver, or cause to be delivered, a receipt for a payment made on a commercial financing transaction when the payment is made in cash or the person requests a receipt, as specified.
   e) Upon repayment in full of a commercial financing transaction, release any security for the transaction, endorse and return any certificate of ownership, and cancel or plainly mark "paid" and return any note, mortgage, security agreement, trust deed, assignment, or order signed by the recipient, as specified and subject to certain conditions.

   f) Deliver to a recipient a statement showing in clear terms the name, address, and license number of the CF provider or broker (if any), at the time the licensee first requires or accepts any signed instrument or the payment of any fee.
   g) Upon a written request from a recipient, deliver, or cause to be delivered, an accurate statement of the total outstanding payment that would be required to pay the obligation in full, as specified.

6) Provides that a commercial financing broker involved in a commercial financing transaction with a small business recipient must:
   a) At the time the final negotiation or arrangement is made, deliver to the recipient and the commercial financing provider a statement showing in clear terms the CF provider's and broker's name, address, and license numbers, as specified.
   b) Deliver to the person making a payment to the broker a receipt for each payment made, at the time it is made, including specified information.
   c) Ensure that the commercial financing provider complies with its obligation to return loan collateral or related materials at the time the transaction is paid in full.
   d) Deliver to any potential recipient, at the time the broker first requires or accepts a signed instrument or the payment of a fee, a statement showing in clear and distinct terms the CF provider's and broker's name, address, and license number.

7) Requires a commercial financing broker to disclose to a prospective small business recipient information concerning the commercial financing transactions referred by the broker in the previous calendar year on or after February 1, including the average, minimum, and maximum combined APRs and estimated APRs disclosed to recipients for consummated commercial financing transactions.
   a) A broker must ensure that this information appears clearly and conspicuously on the broker's website.
   b) A broker shall not engage in further brokering services with a potential recipient who has received this information before the recipient acknowledges the disclosure in writing.

8) Requires a commercial financing broker, when presenting a specific offer to a potential recipient, to clearly and conspicuously disclose to the potential recipient the lowest approximate APR for any commercial financing that the broker reasonably believes the potential recipient could qualify for based on their knowledge and expertise.

9) Provides that a commercial financing broker owes a duty of care to, and has a duty to act in the highest good faith toward, a potential recipient, including the duty to exercise the utmost honesty and integrity toward the potential recipient.

10) Provides that a commercial financing provider may use the underwriting method, as defined, unless the provider participates in a review process, and permits the Commissioner of the DFPI to establish the methods of reporting required for the review process.

11) Restricts a commercial financing provider's use of the terms "interest," "rate," and "APR" to certain contexts.

12) Provides that if, as a condition of obtaining commercial financing, a commercial financing provider requires a recipient to pay off the balance of an existing commercial financing transaction from the same provider, the provider shall disclose the amount of the new commercial financing transaction that is used to pay off the existing transaction that consists of prepayment charges required to be paid and any unpaid interest expense that was not forgiven at the time of the renewal, as specified.

13) Provides that a person who, in this state, contracts for or negotiates a commercial financing transaction with a recipient domiciled in this state to be made outside the state for purposes of evading or avoiding 3)-12) is subject to those provisions.

14) Defines the following terms, in connection with 3)-13):
    a) "Accounts receivable purchase transaction" has the same meaning as defined in Finance Code section 22800: a transaction as part of an agreement requiring a recipient to forward or otherwise sell to the provider all or a portion of accounts, payment intangibles, or cash receipts that are owed to the recipient or are collected by the recipient during a specified period or in a specified amount.
    b) "Asset-based lending transaction" has the same meaning as defined in Finance Code section 22800: 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.
    c) "Charge" includes a profit or advantage of any kind that a licensee may contract for, collect, receive, or obtain by a collateral sale, purchase, or agreement, in connection with negotiating, arranging, making, or otherwise in connection with any commercial financing transaction.
    d) "Referral" is the introduction of a prospective recipient to a commercial financing provider, or the delivery of a prospective recipient's contact information to a commercial financing provider, for the purpose of making an introduction.
    e) "Sensitive data" is any of: a bank account number, a bank statement, a credit or debit card account number, a credit score, all or a portion of a social security number, personal or business income information, or a taxpayer identification number.

f) "Small business" is an independently owned and operated business that is not dominant in its field of operation and meets all of the following criteria:
   i. The principal office of the business is located in California.
   ii. The officers of the business are domiciled in California.
   iii. The business, together with its affiliates, has 100 or fewer employees.
   iv. The business had average annual gross receipts of $15 million or less over the previous three years.

15) Expands the enforcement authority of the DFPI to authorize the DFPI to take licensure action against a commercial financing provider who has repeatedly failed, when making or negotiating commercial financing transactions, to take into consideration the recipient's ability to repay the transaction in determining the size, duration, and repayment features of the commercial financing agreement or contract.

16) Provides that 1)-15) take effect on January 1, 2026.

COMMENTS

1. Author's comment

According to the author:

> As the need for capital continues to grow, new forms of financing have developed to help entrepreneurial Californians receive the monetary means of starting or improving their businesses. These new forms of financing include products like merchant cash advances and factoring. Unfortunately, these new forms of financing exist and operate within the gaps of CA's commercial financing law, as they aren't considered loans. The gaps in CA's commercial financing law allows commercial finance providers and brokers to operate with little to no oversight, exposing small business borrowers to exploitation and manipulation. Because brokers who provide these alternative forms of financing aren't required to be licensed, the state has no means of protecting its small business borrowers from falling prey to broker steering and exploitation. Additionally, the lack of oversight on alternative financing companies allows them to engage in these predatory practices without facing the risk of corrective action. SB 869 requires the state to license commercial financing providers and individuals who provide brokerage services in commercial financing. It also prohibits practices such as broker steering, confessions of judgment, and confidentiality clauses. SB 869 also requires brokers to disclose the average APRs of their previous clients and the lowest-APR option they believe the small business could reasonably obtain alongside their other offers. SB 869 will allow CA to protect its small businesses; it will ensure that entrepreneurial Californians know they are protected. It will improve access to capital and innovation in small

business financing by establishing a level playing field of competition and transparency.

2. <u>California's commercial financing regulations and the gap in the CFL</u>

Consumer protection in the banking and finance sector is a priority for this state. The CFL sets forth a comprehensive regulatory framework for consumer and commercial loans issued by specified financial institutions.[3] 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.[4]

With the advent of different types of commercial financing, however, not all commercial financing entities are covered by the CFL. These alternative financing products include sales-based financing, like merchant advances, lease financing, and factoring – all of which are structured in ways that do not make them "loans" from a legal perspective, though each product serves the same basic function of providing a small business with funds that are paid back over time to the financing provider.

While businesses with steady track records and healthy financial situations may be able to access transparent and low-cost options from banks, such as installment loans or lines of credit, small businesses are more likely to be relegated to these newer, sometimes more confusing, financing options. In particular, newer businesses or those with varying cash flows or high debt burdens may not be able to qualify for bank loans and instead may seek out financing from alternative providers.

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.[5] Last year, the Legislature enacted SB 33 (Glazer, Ch. 376, Stats. 2023), which removed the sunset clause on one of the disclosures required for non-lender commercial finance providers: the requirement that they disclose the total cost of the financing as expressed in an annualized rate, in a format implemented by the DFPI through regulation.

Additionally, last year the Legislature enacted SB 666 (Min, Ch. 881, Stats. 2023), which limited or banned the types of fees that a commercial financing provider may charge to a small business. The bill was specifically aimed at fees that were not covered by SB 1235 and which the author deemed "junk fees," i.e., fees charged without real notice to

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[3] Fin. Code, div. 9, §§ 22000 et seq.
[4] *Id.*, § 22001.
[5] Sen. Comm. on Banking & Financial Institutions on Sen. Bill No. 1235 (2017-2018 Reg. Sess.) Aug. 31, 2018, p. 7; Fin. Code, § 228801.

the recipient and without a meaningful connection to any service provided. The analysis of the Senate Banking and Financial Institutions, which is incorporated here by reference, discusses these measures and other recent measures in greater detail.

3. <u>This bill expands the scope of the CFL to include non-loan commercial financing products offered to small businesses and adds additional protections for small business commercial financing</u>

This bill is intended to ensure that all types of commercial financing instruments offered to small businesses, not just loans, are covered by the CFL. To accomplish this goal, the bill adds definitions for "commercial financing," "commercial financing provider," and "commercial financing broker" to the CFL and includes commercial financing providers and commercial financing brokers to the list of entities that must be licensed under, and are regulated by, the CFL. These definitions are tied to another new definition: a "recipient," which is defined as a small business or small business owner who is presented with a specific commercial financing offer by a commercial financing provider that is equal to or less than $500,000. Accordingly, the bill's extension applies only to small business commercial financing and does not unduly interfere in financing negotiations with larger, more sophisticated businesses.

The bill also adds to the CFL requirements specific to the commercial financing providers and brokers who engage in commercial financing transactions with small businesses. These requirements include prohibiting certain questionable contracting practices, such as taking an instrument with blanks to be filled in; taking a confession of judgment or power of attorney before a default by a recipient; and limiting or restricting the recipient from disclosing information the recipient gains from their business activities with the provider or broker. The bill also adds affirmative obligations for commercial financing providers and brokers engaging with small businesses, which are intended to provide small businesses with information that will help them make prudent financing decisions and avoid surprises once a commercial financing transaction is executed. As discussed below, the author has agreed to make several changes to this portion of the bill in response to concern from the opposition; these changes are intended to preserve the goal of the bill while eliminating provisions that could impose an undue burden on commercial financing providers and brokers or, perversely, make commercial financing transactions more burdensome for small businesses.

4. Arguments in opposition and amendments agreed to in the Senate Banking and Financial Institutions Committee

Opponents of the bill argue that the new requirements are overly onerous and will result in fewer financing options for small businesses. For example, Kapitus and Rapid Finance state:

> [W]e share the author's desire to ensure that providers and brokers of commercial loans and commercial financing operate in a manner that is protective of the small businesses they serve. However, we do not believe that this goal will be achieved by subjecting those brokers to rules with which they cannot comply. To the contrary, we believe that amending California law to add rules with which commercial financing brokers will struggle to comply will deprive California small businesses of services they regularly use to help obtain financing.

In response to opposition concerns, the author has agreed to several amendments proposed by the Senate Banking and Financial Institutions Committee, which is scheduled to hear the bill on January 10, 2024 (the day before this Committee is hearing the bill). These amendments include:

- Exempting, from the definition of "consumer financing broker," persons who perform merely support tasks or engage only minimally in the referral process, such as furnishing a credit report or distributing a provider's marketing materials to a potential recipient.
- Eliminating the requirement that a commercial financing provider deliver a receipt in a specific format every time a payment is made on an account.
- Requiring a commercial financing provider to provide a statement showing its name, address, and license number to a recipient at the time an offer is extended, rather than when the provider first accepts any signed instrument or the payment of fees.
- Requiring a commercial financing provider to provide to a commercial financing broker information about the completed financial transactions that were referred to the provider by the broker, so that the broker can comply with its own obligations to inform small businesses about the rates provided to recipients in prior transactions.
- Clarifying the scope of when a commercial financing broker's obligations arise, to ensure that the bill's requirements apply only when a broker is taking a more active and involved role in the commercial financing negotiations or transaction.
- Eliminating the requirement that a commercial financing broker ensure that a commercial financing provider comply with certain obligations at the time a recipient pays the commercial financing transaction in full.
- Deleting the provision stating that a commercial financing broker owes a duty of care to, and has a duty to act in the highest good faith toward, a potential

recipient, including the duty to exercise the utmost honesty and integrity toward the potential recipient.

The amendments do not address the opposition's concerns about the bill's requirement that brokers provide a best estimate of the lowest APR that a small business may qualify for. As the analysis of the Senate Banking and Financial Institutions Committee notes, the motivation for this provision is understandable; as a practical matter, however, it would likely be difficult for brokers to comply with because brokers might not have the type of comprehensive knowledge about a range of finance providers or the potential recipient necessary to provide a useful estimate. Going forward, the author may wish to work with stakeholders to develop alternative disclosure language.

Because of the tight turnaround between the hearing in Senate Banking and Financial Institutions Committee and this Committee's hearing, it is unknown whether these amendments will remove opposition to the bill.

SUPPORT

None received

OPPOSITION

Forward Financing
Kapitus
Rapid Finance
Small Business Finance Association

RELATED LEGISLATION

Pending Legislation: None known.

Prior Legislation:

SB 666 (Min, Ch. 881, Stats. 2023) restricted restricts specified fees charged to small businesses by commercial financing providers and brokers in connection with commercial financing transactions.

SB 33 (Glazer, Ch. 376, Stats. 2023) removed the sunset provision put in place by SB 1235 (Glazer, Ch. 1011, Stats. 2018) on a specific disclosure term required for entities offering commercial financing products not covered by the CFL.

SB 1235 (Glazer, Ch. 1011, Stats. 2018) established disclosure requirements for specified entities extending commercial financing offers of less than $500,000, including entities offering commercial financing in forms not covered by the CFL.

PRIOR VOTES:

Senate Banking & Financial Institutions Committee (TBD) [6]

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[6] The Senate Banking & Financial Institutions Committee is scheduled to hear this bill on Wednesday, January 10, 2024, the date before this committee hears the bill; as such, the prior committee's vote is unknown at the time this analysis is released.