SB 532- Financial Institutions - Consumer Credit -

Uploaded by: McKinney, Robin

Position: FAV

SB 532- Financial Institutions - Consumer Credit - Sales-Based Financing Transactions
February 23, 2021
SUPPORT

Chairwoman Kelley, Vice-Chair and members of the committee, thank you for the opportunity to submit testimony in support of Senate Bill 664. This bill will protect small businesses by regulating sales-based financing transactions.

The CASH Campaign of Maryland promotes economic advancement for low-to-moderate income individuals and families in Baltimore and across Maryland. CASH accomplishes its mission through operating a portfolio of direct service programs, building organizational and field capacity, and leading policy and advocacy initiatives to strengthen family economic stability. CASH and its partners across the state achieve this by providing free tax preparation services through the IRS program 'VITA', offering free financial education and coaching, and engaging in policy research and advocacy. **Almost 4,000 of CASH's tax preparation clients earn less than $10,000 annually. More than half earn less than $20,000.**

Merchant Cash Advances (MCA) are a popular type of sales-based financing transactions. A MCA is a non-traditional form of financing where a company offers quick and accessible capital to a business without requiring collateral. Lenders give businesses a sum of money, and the small business repay it by enabling the MCA company to directly withdraw a percentage of credit or debit card revenues from the businesses Automatic Clearing House (ACH). **Due to the lack of regulation, small businesses can end up paying extremely high interest rates, and they are at risk of having their bank frozen and funds seized without court involvement.**

MCA companies use a factor rate to determine the cost of the cash advance. They use factor rates as opposed to the more common annual percentage rate (APR). This leads to confusion and small businesses paying high costs to access capital. The rate is determined by numerous elements and is multiplied to the advance amount to determine the overall cost of the cash advance.

- *For example*: If a small business receives a cash advance of $10,000 with a factor rate of 1.5, then that business owes $15,000 regardless of how long it takes to pay.

The almost immediate access to funds that MCAs offer is especially tempting for small businesses with poor credit or in desperate need of cash flow. Small businesses are vulnerable to MCA's, because they operate as an alternative financial service similar to the high fees per loan amount of payday loans. However, unlike payday loans, they are not a regulated service. The Maryland General Assembly passed the Credit Services Business Act and strengthened it in 2010 and 2017 to protect Marylanders from the predatory practices payday loan lenders were employing. Therefore, MCAs and other sales-based financing transactions should be regulated by the state to require clear and transparent terms to their agreements.

The pandemic is creating new and unique obstacles that threaten the security of small businesses, and they must be protected from predatory lending practices. SB 532 will provide protection from MCA's and other sales-based financing transactions, which harm small businesses.

Thus, we encourage you to return a favorable report for SB 532.

ETA Opposition to MD SB 532.pdf

Uploaded by: Behlke, Max

Position: UNF

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February 23, 2021

Senator Delores Kelley
Senate Finance Committee
Maryland Senate
3 East, Miller Senate Office Building
Annapolis, Maryland 21401

RE: Opposition to S.B. 532

Chair Kelley, Vice Chair Feldman, and Distinguished Members of the Finance Committee,

On behalf of the Electronic Transactions Association (ETA), the leading trade association representing the payments industry, I appreciate the opportunity to share our broad concerns with S.B. 532, which would drastically reduce, if not eliminate, a vital financial lifeline for the small businesses in Maryland. ETA supports increasing, not decreasing, choices in small business financing, thus allowing small businesses to select the best product that suits their needs to secure the capital they need to be successful. Therefore, ETA asks this committee to reject S.B. 532 as currently drafted.

Last year, following a hearing in this committee on legislation to outright ban the use of sales-based financing products in Maryland, industry committed to working with the bill sponsors to address problems in the industry created by a small group of bad actors who engage in deceptive offers and business practices. While a dialogue unfortunately never materialized, industry, including ETA, remains committed to working collaboratively and welcomes the opportunity to engage with proponents of the legislation in a sustained dialogue to address their concerns.

In the past year, the pandemic has underscored the importance of sustaining, if not increasing, financing options for small businesses. COVID-19 has forced many businesses to curtail — and in some cases suspend — many aspects of their business to slow the spread of coronavirus. As a result of these unprecedented, although necessary, decisions, the ability of businesses to conduct commerce has been negatively impacted and many are now experiencing a significant drop in revenue.

> **Sales-based financing models, referred to by some as a Merchant Cash Advance (MCA), are designed to directly tie a small business's repayment obligation to their revenue and allow them to address unexpected events that arise and cause a decrease in their revenue, such as COVID, that would otherwise threaten a business' viability through no fault of their own.**

What makes sales-based financing models such a great choice for businesses is that when closed, payments may not be due, and businesses that unfortunately closed for good may not be obligated to pay the remaining portion of their balances because the MCA provider, when offering the MCA, takes the risk that the business may close.

ETA opposes S.B. 532, and similar measures, that would severely restrict, if not eliminate, a valuable option for small businesses seeking financing. Instead, we support pursuing approaches to strengthen protections for small business, while preserving the access to capital that allows those same businesses to thrive. Moreover, ETA opposes S.B. 532 because its provisions create burdensome barriers that will likely hurt the businesses the legislation aims to protect. Logic dictates that reducing (or eliminating) options for small businesses in need of capital will hurt, not benefit, these same small businesses.

ETA's concerns with S.B. 532 include:

- The proposed licensure requirements for "sales-based financing transactions" are overly burdensome and will create barriers to entry into the marketplace, which would lead to fewer options for small businesses seeking financing.
- The requirement to limit sales-based financing transactions to only those with an estimated rate of 24% annual percentage rate (APR) is not a viable option because:
  - The length of time it takes to pay these products off is contingent upon a business' daily revenues, which means that these products are often paid off much sooner than a year.
  - The 24% rate cap is a de facto ban on these products as it is unlikely providers of these products will continue to operate in this state.
- Ineffective regulatory enforcement occurs when regulations only apply to a subset of an industry and not the industry as a whole. We are concerned that the proposed regulation suffers from this problem and we would like time to address the issue to make the legislation more effective across the industry.
- Not all sales-based financing products are alike. The proposed legislation's definitions are drafted so broadly that it would encompass other, non-MCA, forms of sales-based commercial financing that are already subject to regulatory oversight. Imposing unnecessary barriers to entry upon these products – which are not MCAs – will further limit important options for small businesses. S.B. 532 should be more narrowly tailored in its scope and definitions.

The purchase of future accounts receivable is a crucial small business finance lifeline, particularly for new enterprises without pre-established lines of credit with banks. Given how the COVID pandemic continues to threaten the survival of many Maryland small businesses, now is not the time to pass legislation that would threaten one of their financial lifelines. S.B. 532 needs more thoughtful deliberation and industry input to create a clear, fair, and uniform regulatory structure. Therefore, ETA urges the committee to reject S.B. 532 in its current form and welcomes the opportunity to work with the sponsor and proponents of the legislation during the interim to develop a legislative proposal that all parties can support.

Thank you for the opportunity to participate in the discussion on this important issue. If you have any additional questions, you can contact me or ETA Senior Vice President, Scott Talbott at stalbott@electran.org.

Sincerely,

Max Behlke
Director, State Government Affairs
Electronic Transactions Association
mbehlke@electran.org

Background: Purchase of Future Account Receivables or "Merchant Cash Advance"

Sales-based transactions, MCAs, are extremely flexible beneficial to businesses as they have:

- No set terms.
- No set payments.
- No personal guarantee.
- Funder gets paid only when the business is paid.

The purchasing of future account receivables are not loans, but rather, they are a sale of a portion of the small businesses' future credit and/or debit card receivables. When companies provide funds to businesses in exchange for purchasing a percentage of the businesses' daily credit card income, those funds come directly from the processor that clears and settles the credit card payment. A company's remittances are drawn from customers' debit and credit-card purchases on a daily basis until the obligation has been met. Many purchasers form partnerships with payment processors and take a percentage of a merchant's future credit card sales. Purchasers offer an alternative to businesses who may not qualify for a conventional commercial loan and provide flexibility for merchants to manage their cash flow by fluctuating with the merchant's credit and/or debit card sales volume.

The distinguishing characteristic of a purchase of account receivables is that there is no fixed scheduled payment amount or term. When the merchant makes a sale via credit and/or debit card, a percentage of the transaction is forwarded to the purchaser. This continues until the total amount of purchased receivables has been paid. The MCA provider receives the purchased receivables in one of the following ways: (i) the merchant's processor forwards the purchased receivables directly to the funder; (ii) the merchant's receivables are deposited into a lockbox account that forwards the purchased receivables to the provider and remits the balance to the merchant; or (iii) the provider is notified of the amount of the credit card receivables generated and the funder debits the purchased portion from the merchant's bank account.

For many small businesses, the purchase of future account receivables is an alternative to a traditional commercial loan because the transaction does not require personal guarantees from the business owner, only a performance guaranty. The performance guaranty requires that the owner ensure that the business entity complies with all of the terms and conditions of the purchasing agreement. Moreover, unlike a commercial loan which has an absolute right to repay, in the event a business closes, and does not breach the agreement, the business is not held responsible to pay the remaining balance on the agreement. The purchaser takes a risk that a business may close. For example, in May 2018, when Maryland was stuck by severe storms and flooding, any small business that had to close its doors due to the disaster would not be obligated to pay the outstanding balance on the agreement because the business closed, without breaching the contract, as the purchaser assumed the risk in purchasing the future account receivables.

Chris Grimm ILPA Testimony - SB 532.pdf
Uploaded by: Grimm, Chris
Position: UNF

Testimony on Behalf of the Innovative Lending Platform Association
In Opposition to Senate Bill 532

Chair Kelly, Members of the Senate Finance,

The Innovative Lending Platform Association (ILPA) thank you for the opportunity to submit testimony in opposition to Senate Bill 532.

ILPA is the leading trade organization for online lending and service companies serving small businesses. Our members (BFS Capital, BlueVine, Fundbox, Funding Circle, Kabbage, Lendio, Mulligan Funding, OnDeck, and PayNet) offer various financing products, from term loans and lines of credit to merchant cash advance (MCA) and factoring. Our members are proud to provide thousands of Maryland businesses with working capital to purchase inventory, hire additional hands for the busy season, expand the business, or repair damaged or outdated equipment. This isn't the last resort for financing. Our members are the first stop for a quick infusion of cash for many small businesses to invest in their business. Our members use innovative underwriting and the latest technology to quickly evaluate a customer's credit risk and provide financing in as little as 24 hours. We are the FedEx of small business financing.

We share a commitment to the health and success of our nation's small businesses. We are dedicated to advancing best practices and standards that promote responsible innovation and access to capital. The ILPA strongly supports transparency in small business financing disclosures, and our member companies are committed to providing small businesses with responsible and transparent financing options. In 2016, the ILPA created an industry-first model disclosure tool – the SMART Box® – that presents small business borrowers with comprehensive pricing metrics and identifies key loan terms in plain, easy-to-understand language.

Following the 2008 Financial Crisis, small business financing, particularly for the smallest of small businesses, all but dried up. Unless businesses were seeking more than $1 million in financing, banks were not providing the financing small businesses need. ILPA members stepped into that financing gap and are making an extraordinary difference.

ILPA believes that small businesses benefit from having a diverse set of financing options. For some small businesses, more traditional financing products such as term loans or credit lines are the best option. For other businesses, products such as MCAs are the more appropriate option: they offer flexibility that other products may not offer by allowing a business that may have limited assets to borrow against, limited personal credit, or operates a seasonal business. Because instead of a traditional loan or line of credit with set repayment terms, or fixed payments, an MCA is tied to the customer's

revenue. In exchange for an influx of cash, the customer sells a percentage of their future receivables. For example, in exchange for $10,000 of financing, a customer may agree to pay 1% of their daily revenue to the provider until they pay the provider $12,000. For seasonal businesses or businesses with unpredictable cash flow, MCAs allow customers to pay more when business is good and less if business is slow, or even nothing if their revenue is zero. Since there is no repayment term, there also is no benefit for customers to repay the financing early to save money on interest. The price of the financing is fixed.

ILPA recognizes that, like any other industry, there are some bad actors. Some providers are less than truthful about the costs of their financing. This is also why ILPA believes so strongly in transparency and supported efforts in California and most recently in New York, to require small business financing providers, including MCAs, to disclose key metrics and essential terms that customers expect to see, such as APR, customers will be empowered to compare financing products apples-to-apples.

Since every small business and its needs are unique, ILPA must oppose the arbitrary rate cap introduced in SENATE BILL 532. Access to capital is critical for Maryland small businesses. For some of those businesses, an MCA may be the best option. An arbitrary rate cap effectively makes it impractical to offer an MCA product to Maryland small businesses, banning MCAs or changing the economics so that only the most well-off businesses can leverage their sales or future receivables to secure financing.

We appreciate the sponsor's concerns for small businesses. It is a concern we share. All of our members want to see their customers grow and help those businesses succeed at every step of the way. However, we must respectfully request the Committee reject Senate Bill 532 as long as it contains an arbitrary rate cap. We believe there are far better options for protecting small businesses, effectively banning a product, or only making that product available to the most affluent businesses.

ILPA - SB532 - HB664.pdf

Uploaded by: Grimm, Chris

Position: UNF

Innovative Lending Platform Association

Opposition to House Bill 664 /Senate Bill 532

ILPA Contributions to Small Business Success

Following the 2008 Financial Crisis, banks were not offering small businesses the financing they needed or not offering it in a reasonable time frame. This rigid approach to lending leads to discrimination against smaller, newer, and riskier businesses. ILPA members invested in innovative data, analytics, and technology to meet these needs and provide growth funding and opportunity to those small businesses.

When the coronavirus pandemic brought on social distancing and lockdowns, millions of small businesses were forced to close their doors, cut back on hours, and lay off staff. When the federal government launched the Paycheck Protection Program, ILPA members assisted more than 490,000 businesses receive $16 billion in PPP funding. Our technology-based underwriting and experience serving the smallest of small businesses enabled our members to help small businesses stay in business and keep millions of employees on the payroll.

About Sales-Based Financing

For many small businesses, **Sales-Based Financing may be their best financing option. It offers increased flexibility**, making it possible to extend capital to businesses with high receivables but that may have limited fixed assets to borrow against, limited credit histories, or operate seasonally.

Sales-Based Financing offers:

- Repayment options that are tied to actual customer revenue rather than traditional fixed repayment terms from a term loan or a credit line.
- In exchange for an influx of cash, the customer sells a percentage of their future receivables, often from a specific or limited channel like credit card receivables.
- For example, in exchange for $10,000 of financing, a customer may agree to pay 1% of their daily or weekly revenues to the provider until they pay the provider $12,000, with flexibility because fees are only assessed when a sale (receivable) occurs.

Before enacting arbitrary rate caps that would effectively eliminate an entire sector of small business finance in the state or force them to provide financing to the most well-off businesses, the legislature must consider the vital role alternative financing plays in the creation and expansion of small businesses.

Transparency for Small Businesses

In 2016, the **ILPA created an industry-first model disclosure tool – the SMART Box®** [1] which presents small business borrowers with all the critical information they need to make an informed financing decision and to shop and compare multiple offers using common metrics.

ILPA believes in full cost transparency.

- ILPA supports the development of California SB 1235 regulations, the first law in the nation on small business disclosure
- ILPA introduced, and passed into law, legislation in New York to do the same
- ILPA is working with legislators in New Jersey to improve their proposed disclosure bill

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[1] View an example at https://innovativelending.org/smart-box/

By requiring small business financing providers to disclose key metrics and essential terms that customers expect to see, such as APR, customers will be empowered to compare financing products apples-to-apples. We are proud of our work on the **SMART Box® and on these legislative and regulatory disclosure initiatives.**

New York

Last year, ILPA, in partnership with the Responsible Business Lending Coalition, worked with the New York State Legislature to pass the strongest small business financing transparency and disclosure law in the country. The New York Small Business Truth in Lending Act requires small business financing providers to disclose several key metrics, including Total Cost of Capital and APR or Estimated APR, ensuring small businesses have all the information they need to make an informed decision. The New York Small Business Truth in Lending Act should be a model for other states that want to protect small businesses.

Concerns with House Bill 664/Senate Bill 532

We appreciate the need to protect small businesses from bad actors, and this bill is well-intentioned. **ILPA shares a commitment to our nation's small businesses' health and success** and is dedicated to advancing best practices and standards that promote responsible innovation and access to working capital.

While we support requiring disclosure for Sales-Based Financing products, **ILPA must oppose House Bill 664/Senate Bill 532** because:

- Access to capital is critical for Maryland small businesses, and Sales-Based Financing may be the best option for those businesses.
- Arbitrary rate caps that ignore the economics of risk-based pricing will either force Sales-Based Financing providers from the state or force them to only provide financing to the most well-off, least risky businesses. Businesses that already have no problem finding capital.

Small business financing is a very complex and critically important industry, especially during the current crisis and recovery. As such, ILPA respectfully requests that the legislature examine the provisions of this bill closely pursue policy changes that will protect small businesses and ensure choices in the marketplace, particularly for businesses that already have few financing options.

MD Testimony - SB 0532.pdf
Uploaded by: Siegfried, Patrick
Position: UNF

February 23, 2021

Chairwoman Delores G. Kelley
Miller Senate Office Building, 3 East Wing
11 Bladen St., Annapolis, MD 21401
Annapolis, MD 21401

SB 0532 – Oppose

Dear Chairwoman Kelley and Members of the Finance Committee:

Chairwoman Kelley and Members of this committee, my name is Patrick Siegfried and I am here today on behalf of Rapid Financial Services, LLC. Rapid was founded in 2006 and has been headquartered in Montgomery County, Maryland since its inception. To date we have provided over $2 billion in working capital to small businesses throughout the United States. We employ nearly 200 employees at our Bethesda office and have been consistently named as one of the top places to work by the Washington Post.

Our financing products include sales-based financing which is the subject SB 0532. This type of financing allows small businesses to sell a portion of their future revenue in exchange for immediate working capital. Last year, the sponsor of SB 0532 introduced a different bill, SB 0913. That bill would have completely banned sales-based financing in Maryland. After its introduction we met with the sponsor of the bill multiple times and spoke with many of the members of this committee to provide information about sales-based financing and how it is a critical option for small businesses in need of working capital. Thankfully, SB 0913 did not progress out of committee and sales-based financing has continued to be available to small businesses in need of working capital.

In a sales-based financing transaction, there is no repayment term, interest rate, or set payment amounts. And, most importantly, there is no personal guarantee required of the business owner. Because there are no personal guarantee, the risk is placed on the funder. Rapid takes the risk of the business slowing down or even failing. Last year, I testified to these benefits of sales-based financing, and, unfortunately, the COVID pandemic has proven how important they can be to small businesses. As many businesses were shut down due to COVID, those businesses with a sales-based financing product were not required to make any payments. Moreover, if those businesses had to shut their doors forever, the business owners will not be responsible for any remaining balance because there is no personal guarantee. In contrast, small businesses with loans or lines of credit products were still required to make payments under the terms of those transactions throughout COVID and the business owners who guaranteed those transactions are still obligated to ensure that the lender is repaid.

Nationwide, Rapid had 293 customers with sales-based financing accounts that experienced decreased revenue as a result of COVID. In the event these businesses ultimately failed, Rapid would take a loss of $9,187,459.91. However, the owners of these businesses will not owe Rapid anything. In Maryland, Rapid has 10 customers that have been severely impacted by COVID-19. If these businesses, unfortunately, do not survive the pandemic, their owners will walk away debt–free.

Since the introduction of SB 0532, we have continued to speak with the sponsor regarding the bill. However, we are unable to support the bill, as it would restrict access to an important type of working capital. Moreover, it would apply the federal Truth in Lending Act ("TILA") to commercial finance products that the Act was never meant to cover. TILA does not provide any guidance or language in applying APR to commercial financing or more specifically to sales-based financing transactions such as the financing at issue in SB 0532.

While we oppose SB 0532, we are committed to working with this committee, and the sponsors, to create thoughtful and comprehensive legislation to regulate commercial financing.

Sincerely,

Patrick Siegfried
Deputy General Counsel
Rapid Financial Services, LLC

SB 532 informational letter - Merchant Advances.pd

Uploaded by: Sakamoto-Wengel, Steven M.

Position: INFO

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Consumer Protection Division

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CONSUMER PROTECTION DIVISION

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February 23, 2021

To: The Honorable Delores G. Kelley
Chair, Finance Committee

From: Steven M. Sakamoto-Wengel
Consumer Protection Division

Re: Senate Bill 532 – Financial Institutions – Consumer Credit – Sales Based Financing Transactions (INFORMATIONAL LETTER)-

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The Consumer Protection Division of the Office of the Attorney General submits the following letter of information with regard to Senate Bill 532, sponsored by Senator Kramer. SB 532 would require businesses that make "Sales Based Financing Transactions" to be licensed by the Commissioner of Financial Regulation. "Sales–based financing transaction" is defined as a financing transaction that is repaid over time as a percentage of sales or revenue where the payment amount may increase or decrease depending on the volume of sales made or revenue received by the recipient, i.e., a commercial loan. However, SB 532 would make such transactions violations of the Consumer Protection Act (page 3, lines 26-30 and page 25 lines 11-13 and 18-19). Further, as explained to the Division, the bill is aimed to address deceptive offers to businesses that purport to be loans but are instead transactions in which the lender takes a percentage of the business' receivables as repayment. However, SB 532 provides on page 7, lines 23-25, that the statute would *not apply to* a financing transaction in which the recipient *does not* intend to use the proceeds primarily for personal, family, or household purposes. In other words, SB 532 would only apply to consumer, not commercial, loans.

Even if Senate Bill 532 were amended to clarify that it is intended to apply only to commercial loans, with limited exceptions, violations of the Consumer Protection Act are limited to consumer transactions and expanding the CPA to cover business-to-business transactions would open a door that could lead to a significant increase in the number of complaints received by the Division, requiring the Division to add corresponding resources.

Second, while SB 532 appropriately recognizes that regulation of lending in Maryland has primarily been the responsibility of the Commissioner of Financial Regulation, the bill, on page 25, lines 21-25, provides that:

(A) THE COMMISSIONER SHALL HAVE SOLE AUTHORITY TO ENFORCE COMPLIANCE WITH THIS SUBTITLE.
(B) THIS SUBTITLE MAY NOT BE CONSTRUED TO CREATE OR AUTHORIZE A PRIVATE RIGHT OF ACTION AGAINST A PERSON BASED ON COMPLIANCE OR NONCOMPLIANCE WITH THIS SUBTITLE.

These provisions conflict with the provisions cited above that also make a violation of the statute a violation of the Consumer Protection Act, which both provides for enforcement by the Consumer Protection Division as well as a private right of action under section 13-408 of the Act. Since SB 532 was intended to apply to commercial loans, the Division believes this conflict should be resolved by removing all provisions making a violation of the statute a violation of the Consumer Protection Act.

Accordingly, the Consumer Protection Division respectfully requests that the Finance Committee take the points discussed above into consideration with respect to Senate Bill 532.

cc: The Honorable Benjamin Kramer
Members, Finance Committee