ELECTRONIC TRANSACTIONS ASSOCIATION
1620 L Street NW, Suite 1020
Washington, DC 20036
202.828.2635
electran.org

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. <u>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.</u>

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

ELECTRONIC TRANSACTIONS ASSOCIATION

1620 L Street NW, Suite 1020
Washington, DC 20036

202.828.2635
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.