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March 30, 2022

The Honorable C. T. Wilson
Chair, Economic Matters Committee
Maryland House of Delegates
Room 231, House Office Building
Annapolis, Maryland 21401

RE: Opposition to S.B. 825

Chair Wilson, Vice Chair Crosby, and Distinguished Members of the Economic Matters 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. 825.

ETA supports disclosures that promote transparency and accountability for small business borrowers. However, as drafted, S.B. 825 could be confusing for both online small business lenders and the small business community. Moreover, ETA is concerned that the legislation's effective date will not provide regulators with the necessary time to promulgate rules required by the legislation and will not give providers of commercial financing enough time to comply.

Small businesses are the backbone of the economy, but the pandemic has proven they are also the most vulnerable during periods of economic volatility. These businesses have different needs and objectives than consumers – often relying on financing to buy inventory, smooth cash flow, expand their marketing, and the ability to obtain financing that enables them to continue to grow. Small business lenders have developed credit products specifically designed to meet those needs and objectives. ETA supports maintaining choice in small business financing, thus allowing these businesses to select, among multiple available options, the best product that suits their needs to secure the capital they need to be successful. S.B. 825, and similar measures, would impose burdensome barriers for providers of commercial financing, and likely result in less options for the very businesses the legislation aims to protect. Logic dictates that reducing options for small businesses in need of capital will hurt, not benefit, these same small businesses. Therefore, ETA asks this committee to reject S.B. 825 as currently drafted.

Specifically, ETA's concerns with S.B. 825 include:

- **Effective Date**
  - As a threshold matter, S.B. 825 would adopt an effective date of October 1, 2022, which would place an undue regulatory compliance burden on an industry devoting all available resources to sustaining small businesses through their recovery from COVID-19 financial struggles. Given the length of time it has taken the states of California and New York to adopt regulations, let alone implement them, the short timeframe provided by this legislation does not seem adequate. Instead, the legislation should allow for a longer regulatory comment and approval process, which will afford providers sufficient time thereafter to make the complex systemic and operational changes required for compliance with new regulations and disclosures of this complex and de novo nature.

- **Definitions**
  - The legislation references numerous phrases and terms, such as "interest accrued," without defining what these terms mean. Clarifications and precise definitions are necessary to provide

certainty of the bill's requirements and to help ensure the ability to provide accurate and meaningful disclosures in compliance with the law.

- The definition of "provider" should exclude "1st party financing;" specifically, where the owner of the product or service is the one offering the financing opportunity.
- The definition of "recipient" should be limited to persons with a principal place of business in Maryland. In order to determine the recipient's principal place of business, providers should be permitted to rely on either (1) a representation from the recipient, or (2) the business address provided by the recipient.
- The legislation defines "total repayment amount" as the "disbursement amount of a sales-based financing transaction plus the finance charge". This definition needs to be refined to address situations where the "total repayment amount" and the "disbursement amount" are not the same, for example, where a provider is paying off a third-party on behalf of the recipient.

  For example, a provider provides a recipient with a $20,000 loan with a finance charge of $2,000. However, the provider has to pay-off a third-party $3,000, which means that the recipient is going to receive a disbursement of $17,000. The disbursement of $17,000 plus the finance charge of $2,000 equals $19,000, not the actual total repayment amount of $22,000.

  This is just one example of where the definitions do not take into account all scenarios that actually occur.

- **Annualized Percentage Rate**
  - ETA is concerned that S.B. 825, by mandating an annual percentage rate or estimated annual percentage rate (collectively "APR") disclosure for commercial financing, will create significant confusion and uncertainty for Maryland small businesses trying to make informed decisions about the cost of financing products. The Truth in Lending Act ("TILA") was enacted strictly for consumer transactions, not commercial transactions and does not take into account the unique payment features of sales-based financing products, which do not have a fixed term, fixed payments, or have an absolute right to repay.
  - Even the Consumer Financial Protection Bureau in its recent proposed regulations for Sec. 1071 of Dodd-Frank stated that because these types of products do not have a defined term or a periodic payment amount, it would require a funding company to assume or estimate parts of the APR formula, which only increases complexity. This is not a simple calculation and funding companies have to make a lot of assumptions in order to provide a small business with an Estimated APR, which in turn could lead to misleading disclosures, even if that was not the intention of the funding company.
  - As an alternative to APR, ETA urges the committee to consider Total Cost of Capital ("TCC") as the method for disclosing the cost of financing products, which is what matters to small business owners. TCC captures all interest and fees (for certain products that do not charge interest, but rather a fixed fee for capital) that are a condition of receiving capital. TCC is readily calculable and provides the clearest, most accurate basis for comparison among commercial finance options, no matter how they are denominated.

- **Calculation of APR for Daily Payment Products**
  - The bill states that APR should be calculated in accordance with the TILA. The issue is that this legislation does not provide the necessary information to calculate APR for a daily payment product. Each month has a different number of days in which payments are collected and providers need to know how many payment days (not calendar days) to assume exist in every month. Simply assuming that payments can be made every calendar day is misleading because it's impossible to make a payment every day and this would assume more payments than actually can be made, thereby artificially inflating the APR, and leading to a misleading disclosure for daily payment products.

- **Sales-Based Financing APR Reporting**
  - S.B. 825 requires providers of sales-based financing to report to the Commissioner each year (1) the estimated APR rates given to each recipient, and (2) the actual APR rates of each completed sales-based financing transaction. This would arguably require the provider to recalculate the APR of each sales-based financing at the time the recipient pays off the balance. ETA does not understand how this type of calculation will be beneficial to anyone. Moreover, the lack of a precise definitions for this requirement would have it apply across multiple scenarios. For example, if a recipient decides to pay off a sales-based financing early for any reason, such as the recipient's desire to obtain a new financing product or a sudden increase in the recipient's cash flow, the actual APR will vary (possibly significantly) from the original estimated APR. Additionally, if the sales-based financing were to become charged off or subject to a workout arrangement, the actual APR will (possibly significantly) for the original estimated APR. ETA is unclear as to how this requirement would result in producing meaningful data. ETA strongly opposes this requirement and any similar requirement, which could result in a false appearance that a provider is significantly underestimating the APR.

- **Disclosure of the Amount of Average Projected Payments Per Month (for periodic payments that are not monthly)**
  - The requirement of a monthly payment amount disclosure for products that do not have a monthly payment is problematic for two reasons (1) it is confusing to the small business and (2) it expresses a preference for products that ultimately may be more expensive. Requiring disclosure of the actual frequency and amount of payments makes sense and is helpful to the small business. Requiring disclosure of a hypothetical frequency and amount is potentially harmful because of the confusion it could create. Small businesses may not understand why they are receiving a disclosure of a hypothetical monthly payment, and instead assume that they can pay monthly when, in fact, the financing contract requires payments of a different frequency. Adding such confusion is contrary to the purpose of the bill, which is to provide clear and transparent disclosures.
  - Requiring disclosure of an average monthly cost for payments that are not monthly expresses a preference for products with monthly payments because products with monthly payments will have a lower average monthly cost than products with daily or weekly payments, as monthly payment products typically have longer terms. This ignores the reality that products with monthly payments may have a higher overall total cost due to the fact that the small business is paying interest over a longer term. Thus, a critical consideration is the overall total cost of a product as

well as the periodic payment. More importantly, the disclosure seems likely to cause confusion given that the information would conflict with the written terms of the commercial financing agreement. The average monthly cost of a product is not relevant if it does not reflect the actual payments a small business is required to make, or even the actual monthly cost, given that daily, weekly, and bi-weekly payment frequencies all will have different monthly costs and different averages.

- **TILA Disclosure Exemption**
  - The New York commercial financing disclosure law (CFDL) provides that the definition of "commercial financing" **(b) does not include any transaction in which a financier provides a disclosure required by the Truth in Lending Act, 15 U.S.C. § 1601 et seq., that is compliant with such Act**. This provision prevents unnecessary duplication of disclosures from providers who already provide TILA compliant disclosures in commercial financing transactions and encourages uniformity across the country rather than requiring different disclosures in each state, dependent on the specific requirements of a CFDL.

- **Renewal Financing**
  - S.B. 825 requires disclosures for renewal financing that will likely cause confusion. While we are not opposed to disclosing how much of any new financing is being used to pay-off existing financing from the same provider, we think it should be a clear, succinct notice or a simple disclosure. The amount of disclosures and explanations required of financing providers is already voluminous and, with additional language and disclosures, will confuse the recipient and increase the likelihood that the recipient might not even read any of the disclosures.
  - The legislation requires providers of renewal financing transactions to disclose any "double dipping" as described in the legislation. First, double dipping is not a formal term and is not widely used throughout the industry. Second, the term, as defined, fails to consider how renewal financing works in practice. For example, at the time the disclosure is given, the balance on the existing financing will most likely change prior to consummation of the new financing agreement. Therefore, the amount of the new financing that is used to pay-off prior financing could be less if additional payments on the prior financing are made or could be more if a recipient misses a payment.
  - Therefore, ETA suggests replacing the "double dipping" question with a statement that "part of your renewal financing will be used to pay-off your current financing with [name of provider]."

- **Other State Commercial Financing Disclosure Laws**
  - California and New York have passed commercial financing disclosure laws, however, neither law has gone into effect because of the complexity of the issues. California has held at least eight rounds of comments on proposed regulations and New York has made two similar requests, even though they borrowed from much of the work already completed by California.
  - The current draft of S.B. 825 directs the Maryland Commissioner of Financial Regulation to adopt regulations substantially similar to those adopted by the New York Department of Financial Services ("DFS"), however, the New York disclosure bill has numerous issues that have not been addressed. The DFS is aware of these issues and has even pushed back the implementation date to an unknown date because of all the problems surrounding the disclosures and the potential for

providers to provide misleading disclosures. ETA proposes that the Commissioner wait until the NY disclosure law and associated regulations are finalized, in effect and smoothed out before enacting the provisions of this bill and that, with the exception of requiring APR calculations, this legislation mirror the NY law and associated regulations. It will be nearly impossible for providers of small business financing to comply with two or more varying state laws governing commercial financing disclosures.

- **Timing of Signatures**. For example, S.B. 825 requires a recipient to sign the required disclosures "before a provider may allow the recipient to proceed with the commercial financing application" whereas the NY commercial financing disclosure law requires the recipient to sign "prior to consummating a commercial financing". ETA is unclear what Maryland's version of this provision means. It could mean that the recipient must sign the disclosures prior to accepting the offer, in the middle of the application process, prior to funding or some other point in time. Additionally, if a recipient is given multiple pricing options, the recipient should only be required to sign disclosures for the pricing option that the recipient accepts. Ideally, a recipient will be required to sign the disclosure "prior to consummating a commercial financing" as is required by the NY law. That way, the recipient will be able to sign the disclosures simultaneously with any other documentation and the standards for NY and MD will be consistent.

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 their commercial financing options by creating burdensome and confusing barriers for small business lending providers. S.B. 825 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. 825 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
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Background: Purchase of Future Account Receivables or "Merchant Cash Advance"

Sales-based transactions, MCAs, are extremely flexible and 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.