The Honorable Pamela Beidle, Chair
The Honorable Katherine Klausmeier, Vice Chair
Maryland Senate Finance Committee
3 East
Miller Senate Office Building
Annapolis, Maryland 21401

February 13, 2024

RE: SB 509 – Opposed Unless Amended

Dear Chair Beidle and Vice Chair Klausmeier,

The Revenue Based Finance Coalition ("RBFC") respectfully opposes SB 509 as currently drafted. RBFC members are responsible finance companies that provide needed capital to small and medium sized businesses nationwide. Our member companies offer fair and innovative financing and have filled the void created by the decline in small business lending by larger, traditional banks. Our members are committed to providing clear and accurate cost of capital disclosures to our small business customers.

SB 509 Will Prevent Small Businesses from Accessing Needed Capital

<u>Five state legislatures to date have adopted a "Total Cost of Capital" model of disclosure for commercial financing products instead of "APR" disclosures.</u>

- Connecticut, Virginia, Utah, Florida, and Georgia have all adopted "Total Cost of Capital" disclosure models for commercial financing in their states because that is an appropriate metric for commercial financing.

- For example, in Connecticut the codified disclosure legislation mandates that small businesses are given the following disclosures:

    1. The total amount of the commercial financing
    2. The disbursement amount, which is the amount paid to the recipient or on the recipient's behalf.
    3. The finance charge.
    4. The total repayment amount, which is the disbursement amount plus the finance charge.
    5. The estimated time period required for the periodic payments to equal the total repayment amount.

6. The payment amounts, either fixed or variable, and the corresponding payment schedule or description of the method used to calculate the schedule of payments.
7. A description of all other potential fees and charges not included in the finance charge, included but not limited to draw fees, late payment fees, returned payment fees, etc.
8. Any charges for early repayment and any charges not already included in the finance charge.
9. A description of any collateral requirements, if any.
10. Any compensation a provider will pay directly to a broker out of the financed amount.

- Virginia, Utah, Florida, and Georgia have also codified these same, or very similar, disclosure requirements.

- "Annualized Percentage Rate" ("APR") is not an appropriate metric for a revenue-based finance ("RBF") product because there is no maturity date or fixed term of repayment. Instead, RBF payments to the provider are tied to actual business receipts. If revenue decreases, the business can require the funder to accept smaller payments until revenue increases.

- APR is an appropriate metric for certain consumer financial products such as credit cards or mortgages that have a fixed term, compounding interest, and usually carry over year to year.

- Revenue-based financing, invoice factoring, and other types of commercial financing do not have fixed terms or compounding interest; the costs are fixed at the time of closing and are not based on the time period it takes for the business to pay its obligations.

- Therefore, calculating an APR, or estimated APR, for these commercial financing products does not give a small business owner a clear indication of how much money they will pay back to a funder. In fact, if forced to calculate and publish an APR on disclosure forms, the APR will likely be misleading and inaccurate due to the variability of daily revenue generated by a business.

<u>SB 509 would require commercial financing providers to provide a misleading "Estimated APR" disclosure.</u>

- An "Estimated APR" disclosure can be manipulated to make more expensive financing choices appear less costly.

- SB 509's proposed methods to calculate an "Estimated APR" will not result in a reliable and consistent APR that can be compared among other financing providers.

- Because the actual repayment amounts of a revenue-based financing transaction are based on the economic and market realities of each small business customer, an "Estimated APR" disclosure that is based on historical estimates and assumptions is of little value.

What is Revenue Based Financing?

RBFC members help meet the needs of American small business entrepreneurs by providing financing to qualified small businesses. Revenue-based financing ("RBF") is a form of flexible financing in which payments are adjusted as a percentage of business revenue. RBF allows businesses to access funds for, as an example, a seasonal inventory surge or to replace an unexpected major equipment failure.

In an RBF agreement:

- As opposed to traditional lending products, the business remits a contractually specified percentage of its future revenue. If revenue decreases, then the business has the right to correspondingly decrease its remittances.

- The RBF funder agrees up front to take the risk that the business's revenue will be generated slower than expected and the risk that the business will fail or go bankrupt.

  Example. If an RBF company purchases 10% of a business's future revenue up to a purchased amount of $10,000, the transaction would be completed whenever the business succeeded in generating $100,000 in revenue, and remitted 10% of that revenue to the RBF funder. This milestone could be achieved in a month, a year, or never.

Advantages of Revenue Based Financing

RBF has many advantages for small businesses:

- Unlike traditional consumer loans, or other loan products, there is no absolute obligation to pay. If, in the ordinary course of doing business, the business fails, then the RBF funder will have no recourse against the business.

- Funds can be provided to the business in as little as 24 hours.

- The incentives of the RBF funder and the business are aligned because the RBF funder's compensation is contingent on the business's continued success.

- Unlike most Small Business Association loans, the business owner does not need to use his or her house as collateral.

- The business owner does not enter into a partnership, nor does it give up control of the business.

Thank you for the opportunity to provide comments. We look forward to participating in discussions regarding this legislation.

Sincerely,

Mary Donohue

Mary Donohue
Executive Director