REVENUE BASED FINANCE COALITION

The Honorable C.T. Wilson, Chairman
The Honorable Brian Crosby, Vice Chairman
Economic Matters Committee
Room 231
House Office Building
Annapolis, Maryland 21401

February 11, 2025

RE: HB 693 - Opposed Unless Amended

Dear Chairman Wilson and Vice Chair Crosby,

The Revenue Based Financing Coalition ("RBFC") respectfully opposes HB 693 as currently drafted. RBFC members are responsible financing 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 disclosures to our small business customers.

This letter outlines for the Economic Matters Committee:

- Why HB 693 is outdated and what other states have enacted in recent years.

- Virginia's disclosure law enacted in 2022 and the benefits of having a uniform disclosure law across the DC, MD and VA (DMV) region. The Maryland Legislature has a history of adopting specific disclosure forms, instead of leaving the development of a disclosure form to a regulatory agency. We respectfully ask the Maryland Legislature to consider adopting a disclosure form similar to Virginia's disclosure to ensure that business owners are receiving similar information across the DMV region.

- Why an "Estimated APR" disclosure does not work for the sales/revenue-based financing product and examples of why APR is a distorted cost disclosure.

The current version of HB 693 diverges from that of Virginia and the six other states that have rejected an APR disclosure in favor of a "Total Cost of Capital" disclosure. Uniformity across the DMV region will provide meaningful comparisons across financial products.

1. **HB 693 is Outdated and Diverges From Seven Other State Disclosure Models - Including Virginia. Businesses of the DMV Should Receive the Same Disclosure Information.**

Seven state legislatures across the country have adopted a "Total Cost of Capital" model of disclosure for commercial financing instead of models that include an "Estimated APR" disclosure.

- Virginia[1]
- Utah[2]
- Connecticut[3]
- Florida[4]
- Georgia[5]
- Kansas[6]
- Missouri[7]

In 2021, the Virginia legislature codified "Total Cost of Capital" legislation to enact a disclosure regime for sales-based financing products. Disclosures in the Virginia law include the total amount of the sales-based financing, the disbursement amount, if different from the financing amount, and any fees deducted or withheld at disbursement, among others.[8] The law went into effect on July 1, 2022.[9] We have included a copy of the Virginia Sales-Based Financing Disclosure form in this letter (Figure 5.).

In contrast, the Maryland legislature has been debating the passage of an "APR-style" disclosure law[10] for the past several years. The key differences between HB 693 as it compares to Virginia's law are as follows:

- Expansion of the bill's purview to cover all non-bank commercial financing products, equipment lease agreements, and factoring transactions; and
- Inclusion of the disclosure of an estimated Annual Percentage Rate (APR);
    - APR is not suitable for the sales-based financing product and leads to an inaccurate and misleading disclosure.[11]
    - Sales-based financing products are not loans and do not have interest rates or compounding interest.[12]

---

[1] https://law.lis.virginia.gov/admincode/title10/agency5/chapter240/section30/
[2] https://dfi.utah.gov/non-depository/commercial-financing/
[3] https://www.cga.ct.gov/2023/act/pa/pdf/2023PA-00201-R00SB-01032-PA.pdf
[4] https://www.flsenate.gov/Session/Bill/2023/1353/BillText/er/PDF
[5] https://www.lexology.com/library/detail.aspx?g=9a8486de-37b4-4c6c-a9ab-6a83f9e6ca1a
[6] https://kslegislature.gov/li_2024/b2023_24/measures/documents/summary_sb_345_2024
[7] https://www.senate.mo.gov/24info/BTS_Web/Bill.aspx?SessionType=R&BillID=101
[8] Sales-Based Financing Disclosure Form-20220503090011.pdf
[9] 10VAC5-240-30. Sales-Based Financing Disclosure Form.
[10] Legislation - SB0509
[11] 20240124_03.pdf
[12] What You Should Know About Revenue-Based Financing For The E-Commerce Industry

- 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.[13]

The non-bank commercial financing industry has been advocating for uniformity in disclosure standards across the country. New York and California are the only states to codify disclosure legislation with an APR disclosure. Since those laws were enacted seven other states, including Virginia, have codified disclosure laws without APR.

We respectfully ask that you consider adopting a Virginia-style disclosure model to promote a uniform disclosure across the DMV area. All businesses in the DMV area applying for commercial financing products should receive similar disclosures as they pertain to sales or revenue-based financing.

Size and Scope of Businesses in the DMV Area: According to recent census data, in the combined DC/MD/VA (DMV) area alone, there is a population of approximately 9 million people.[14] Figure 1. below shows the Washington-Baltimore-Arlington combined statistic area delineating the counties within the greater DMV area.[15]

Data compiled from the Small Business Administration (SBA)'s 2024 Small Business Profiles per state (with data pulled from the U.S. Census of 2021 SUSB Annual Data Tables)[16] show the various small business profiles of DC[17], MD[18], and VA[19] divided by county (see Figures 2.-4. below).

There is significant overlap within the DMV area of business operation (both small and medium/large) regardless of state and district boundaries. Within the Washington-Baltimore-Arlington combined statistical area there are approximately 200,000 business establishments employing over 3.4 million people[20].

The implications of the large amount of businesses with high population density in a relatively small space are enormous to interstate commerce. Millions of people are working for businesses and utilizing the services of businesses across the VA, MD and DC boundaries. Anecdotal data suggests that residents of the three states travel outside of those boundaries to work and support those businesses in mass scale quantities. There is significant overlap for business owners and business patrons within the DMV area. For example, business owners may live in Virginia but own a business in Maryland or vice versa.

---

13 15ws6c9Rk_bWMVSXdkSanIdoPIJj0o5sZ.pdf
14 https://www.census.gov/library/visualizations/interactive/2020-population-and-housing-state-data.html
15 Map of the 2012 OMB-designated Washington-Baltimore-Arlington, DC-MD-VA-WV-PA Combined Statistical Area.
16 2021 SUSB Annual Data Tables by Establishment Industry
17 District of Columbia 2024
18 Maryland 2024
19 Virginia 2024
20 https://www.census.gov/data/tables/2021/econ/susb/2021-susb-annual.html

RBFC & Industry Footprint in DMV Area: The 200,000 businesses in the Washington-Baltimore-Arlington area are serviced by not only RBFC members but by the wider sales/revenue-based financing industry.

We estimate that our RBFC membership alone (consisting of about 35 funder companies) within the past year has serviced over 1,000 businesses in the state of Virginia and deployed over $24 million of capital. In Maryland, by our same estimations, our membership has serviced over 1200 businesses in the state and have deployed over $23 million of capital. In the District of Columbia, our membership serviced over 120 businesses deploying over $3.5 million in capital within the past year.

The year-to-year impact of the RBFC membership in all three states combined totals approximately 2400 businesses served each year with over $50 million in capital infused into the DMV region.

We can estimate a broader scope of the entire sales-based financing industry's impact on the region by examining Virginia's registration of sales-based financing companies. Virginia implemented a registry for sales-based providers in the state consisting of 213 companies.[21] Just by our RBFC membership volume we can estimate that Virginia and Maryland probably have similar sales/revenue-based financing footprints based on volume and businesses served with the District of Columbia having significantly less volume. If just 35 revenue-based financing companies are providing a combined amount of $50 million dollars to businesses in both MD, VA and DC each year, one could estimate that the entire industry is providing all three states approximately $300 million annually to approximately 14,000 businesses.

The Impact of Differing Disclosure Forms in the DMV Area: Businesses across the DMV deserve to have the same disclosure information presented to them when applying for financing from non-bank financial institutions. The Virginia disclosure law has been implemented since 2022 and is working year-to-year to provide businesses with uniform and informative disclosures so businesses can make informed decisions about the financing they are seeking. We urge the Maryland legislature to implement the same disclosure requirements for continuity across the DMV area.

Examples of Disclosure Forms Required by the Maryland General Assembly Instead of by a Regulator: We would also like to highlight briefly examples of forms that are required by Maryland statute, rather than by a regulation. During and after the foreclosure crisis, the Maryland General Assembly passed foreclosure-related legislation. In most cases, the General Assembly delegated the authority to prepare forms and notices to regulators but there were some instances when the General Assembly provided a specific form or notice.

Please see Md. Code Ann., Real Prop. §§ 7-105.11(b), (c), (d); 7-113(c)(1), and 7-306(a)(6) and 7-306(c)(1) and (2).

---

[21] DataWindow

The legislature has the power to adopt a Virginia-style disclosure form to provide businesses in the DMV area uniform disclosure standards.

2. **"Estimated APR" Defeats the Purpose of an APR Disclosure and does not allow for a true cost comparison across RBF offers or different financial products.**

An APR calculation is designed to provide the proverbial apples-to-apples comparison of the cost of various closed-end consumer loan offers. As explained in the American Bar Association's treatise, *The Law of Truth in Lending*:

> Of all the credit terms that TIL requires the creditor to disclose, consumer borrowers are most aware of the APR. Indeed the APR is probably the most valuable TIL disclosure, for APRs allow debt alternatives to be compared conveniently and meaningfully even if the borrowings differ in amount or duration or repayment arrangements…

A primary purpose of TIL is to enhance cost awareness and to promote market information about credit terms and price, any success that TIL enjoys in this regard is due in large part to the credit cost comparisons that APR permits. A rate comparison allows debts configured quite differently to be compared as to *level* of cost, that is, the relative cost of a unit of credit for a constant amount of time. Such a comparison is only possible if a comprehensive effective "interest rate" measure (such as APR) is available.[22]

Unfortunately, this is where the "Estimated APR" disclosure[23] for commercial financing falls flat. In particular, sales-based financing providers offer a product that is materially different from the closed-end consumer loans contemplated by the Truth in Lending Act. The "Estimated APR" disclosure required for sales-based financing is based on a fictitious payment schedule. By contrast, an actual APR disclosure is based on an actual payment schedule. Estimated APR will always fail to provide an apples-to-apples comparison with an actual APR.

A. How to Calculate an "APR".

A financing provider needs three data points to calculate an APR:

1. The amount of financing provided;
2. The finance charge; and
3. The repayment schedule.

The financing provider then applies the mathematical formula supplied by Appendix J of Regulation Z, which implements the federal Truth-in-Lending Act.

B. How to Calculate an "Estimated APR" for Sales-Based Financing – Create a Fictional Payment Schedule Based on Unreliable Estimates and Assumptions.

---

[22] Ralph Rohner & Frederick Miller (Alvin C. Harrell, editor), *The Law of Truth in Lending* (2014) at 255-257, citing T.Durkin & G. Elliehausen, 1977 Consumer Credit Survey 17 (Federal Reserve Board 1978) and associated tables.

[23] Forms of commercial financing with fixed repayment terms, such as closed-end loans, require disclosure of an Annual Percentage Rate, not an Estimated Annual Percentage Rate.

A sales-based financing provider needs three data points to calculate an APR:

1. The amount of financing provided;
2. The finance charge; and
3. A fictional repayment schedule. A sales-based financing transaction does not have a repayment schedule. Payments are based on the amount of daily revenue a business receives. Estimated APR forces a sales-based financing provider to create a fictional payment schedule that does not reflect the legal obligation of the parties under the financing contract and using the following procedure:

Fictional Repayment Schedule Step 1: Choose whether to use the ”Historical Method” or the “Opt-In Method” to calculate the business's estimated future monthly revenue:

- The “Historical Method” requires a financing provider to consider between one and 12 months' worth of average sales data, with each financing provider allowed to choose how many months' worth of data to review. As a result, two different financing providers could calculate different amounts of estimated future monthly revenue for the same business, depending on how many months of data they choose to review.

- The “Opt-In Method” instead allows a finance provider to use whatever “projected sales volume that the provider chooses for each disclosure.” As a result, two different financing providers could calculate different amounts of projected sales volume for the same business, depending on whatever information they elect to review.

The Estimated APR disclosure assumes that the business's revenue in the future will be similar to the business's revenue in the past. As noted, it is not possible to know the schedule of payments the financing provider will receive in connection with sales-based financing because the payments are contingent on actual sales. The financing provider agrees to purchase a certain dollar amount of a business's receivables in return for (typically) daily remittances of a fixed percentage of the business's daily sales. Because the financing provider cannot know the amount of sales the business will achieve on any particular date, an initial estimated daily payment amount established by the financing provider.

Fictional Repayment Step 2: Consider how the “True-Up” mechanism changes the fictional repayment schedule:

- In sales-based financing, the business's payment obligation is based on the business's sales revenue. The business has the right to a “true-up”, which recalculates the business's periodic payment to more closely approximate the percentage of sales the business is obligated to deliver to the financing provider. For example, it is possible that a “true-up” would reduce the business's daily or weekly payment from $1,000 per day to $500 per day. A sales-based financing provider cannot predict with certainty which businesses will be among those obtaining a true-up because it cannot know which businesses will have a slowdown in sales.

- It also is likely that two financing providers, even if both were to correctly anticipate a true-up, would assume different adjusted payment amounts and new payment schedules. Because the resulting new payment schedules would be different, the disclosed Estimated APR would be different, even for the same offer to the same business. The fact that the same financing terms can result in very different Estimated APRs highlights the ineffectiveness (and misleading nature) of an annualized rate disclosure for sales-based financing.

- Because longer repayment terms result in lower APRs (all else being equal), the requirement to account for true-ups allows manipulation of the Estimated APR. The lower the new payment after a true-up, the longer the repayment term and the lower the Estimated APR. A financing provider desiring to get a competitive edge may be encouraged to assume that businesses will request true-ups and that the resulting adjusted payments will be significantly less than the initial payments.

Fictional Repayment Step 3: Create a fictional repayment schedule based on Steps 1 and 2. Include additional assumptions that impact the payment schedule such as bank holidays.

To summarize, in order for an APR disclosure to be meaningful, identical offers should produce identical estimated annual percentage rates. As explained above, with an "Estimated APR" disclosure there is little likelihood of that.

C. <u>Hypothetical Examples Highlighting the Issues Cited Above</u>.

We calculated Estimated APRs for a single hypothetical sales-based financing transaction. These examples all assume the financing provider has agreed to purchase $60,000 of future receipts for $50,000 and that payments are due daily starting May 2, 2023. In each case, payments are set at an amount that is 10% of the anticipated daily income of the recipient. There are no prepaid finance charges. In each case, the "amount financed" is $50,000 and the "finance charge" is $10,000.

These examples highlight the wide discrepancy in Estimated APRs that result from different financing providers making different assumptions in preparing disclosures for the same offer. The Estimated APRs vary from 25.20% to 46.97%, depending on:

1. The method of determining the recipient's average monthly income (which impacts the daily payment amount);
2. Whether the financing provider reasonably anticipates a true-up;
3. The timing of any reasonably-anticipated true-up; and
4. The amount of the payment after a reasonably anticipated true-up. Spreadsheets showing the calculations and results for each of these examples available upon request.

- Calculation #1: In this example, the financing provider uses the Historical Method to estimate daily income of $2,500 using four months of historical data. This results in 240 payments of $250 per day.

Estimated Annual Percentage Rate: 39.09%

- Calculation #2: In this example, the financing provider also uses the Historical Method to estimate daily income but uses 10 months of historical data instead of four and, as a result, estimates daily income of $3,000. This results in 200 payments of $300 per day.

Estimated Annual Percentage Rate: 46.97%

- Calculation #3: In this example, the financing provider uses the Opt-In Method and estimates daily income of $2,000. This results in 300 payments of $200 per day. (This could also result from using the Historical Method and a different number of months of historical data than used in Calculations 1 and 2).

Estimated Annual Percentage Rate: 31.30%

- Calculation #4: In this example, the financing provider estimates $2,500 in daily income (the same as in Calculation #1), but believes it is reasonable to anticipate a true-up after the 20th payment. As a result of the reasonably anticipated true-up, the financier assumes a new payment of $200 per day for 275 payments (the remainder of the obligation) starting with the 21st payment.

Estimated Annual Percentage Rate: 32.40%

- Calculation #5: In this example, the financing provider estimates $2,500 in daily income (the same as in Calculation #1), but believes it is reasonable to anticipate a true-up after the 40th payment, instead of after the 20th payment as in Calculation #4. As a result of the reasonably anticipated true-up, the financing provider assumes a new payment of $200 per day for 250 payments (the remainder of the obligation) starting with the 41st payment. Here, the payment after true-up is the same as in Calculation #4, but the financing provider assumed a different timing for the true-up. This disparity would be further amplified by a more lengthy delay between origination and the assumed timing of the true-up.

Estimated Annual Percentage Rate: 33.45%

- Calculation #6: In this example, the financing provider estimates $2,500 in daily income (see Calculation #1), but believes it is reasonable to anticipate a true-up after the 20th payment (same as in Calculation #4). However, this financing provider assumes the daily payment after true-up will be $150 (not $200 per day). As a result of the reasonably anticipated true-up, the financing provider assumes a new payment of $150 per day for 366 payments and a final payment of $100 (the remaining balance).

Estimated Annual Percentage Rate: 25.20%

As made clear by the above examples, the annual percentage rate is a misleading measure of the cost of financing. The finance charge is $10,000 in each of these examples, but the disclosed “Estimated APR” swings from 25.20% to 46.97%. This actually hinders the goal of providing for apples-to-apples comparisons.

3. 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.

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 24-48 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/equity 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
Revenue Based Finance Coalition

Figure 1. OMB-designated Washington-Baltimore-Arlington, DC-MD-VA-WV-PA Combined Statistical Area Map

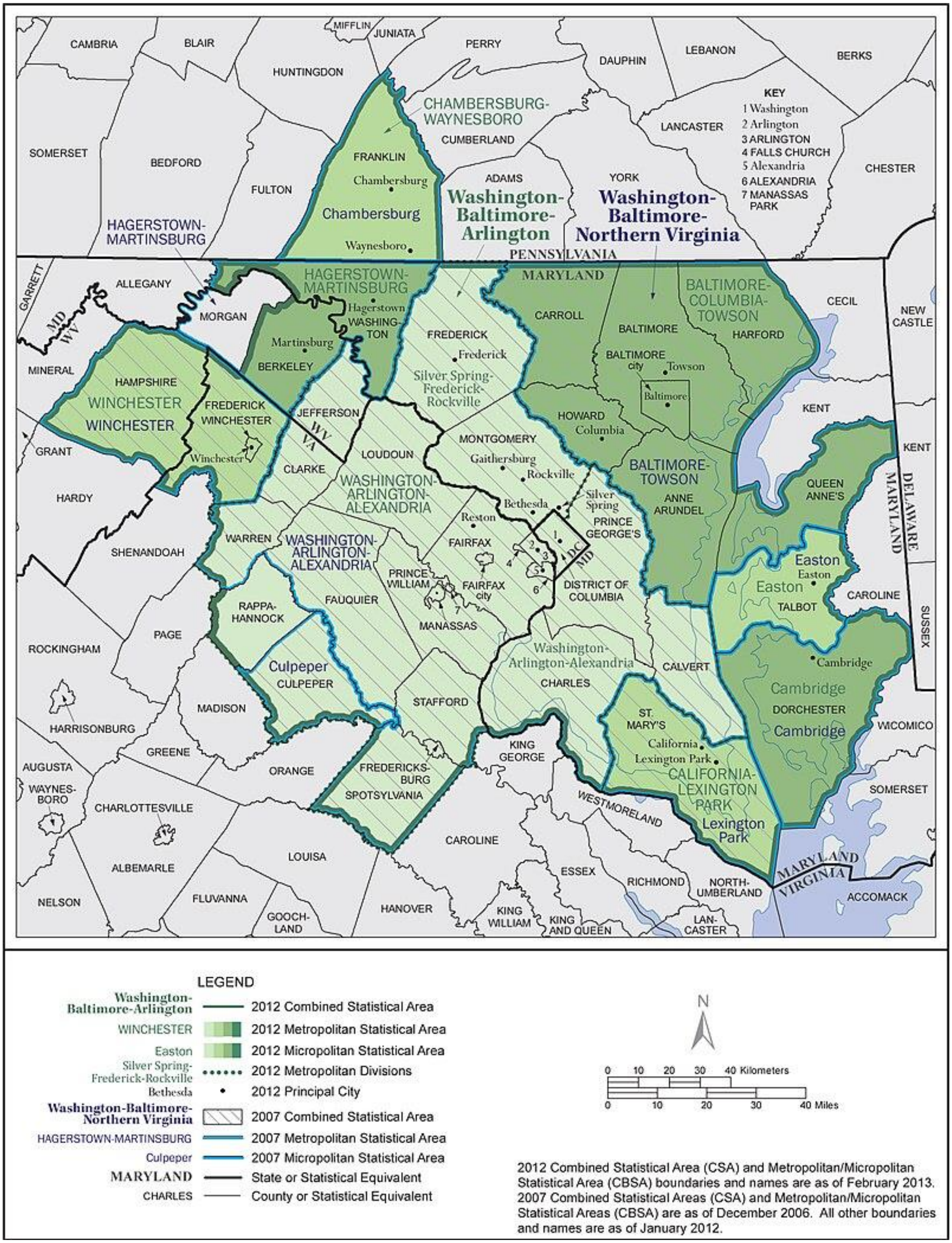


Figure 2. SBA 2024 Small Business Profile - Virginia

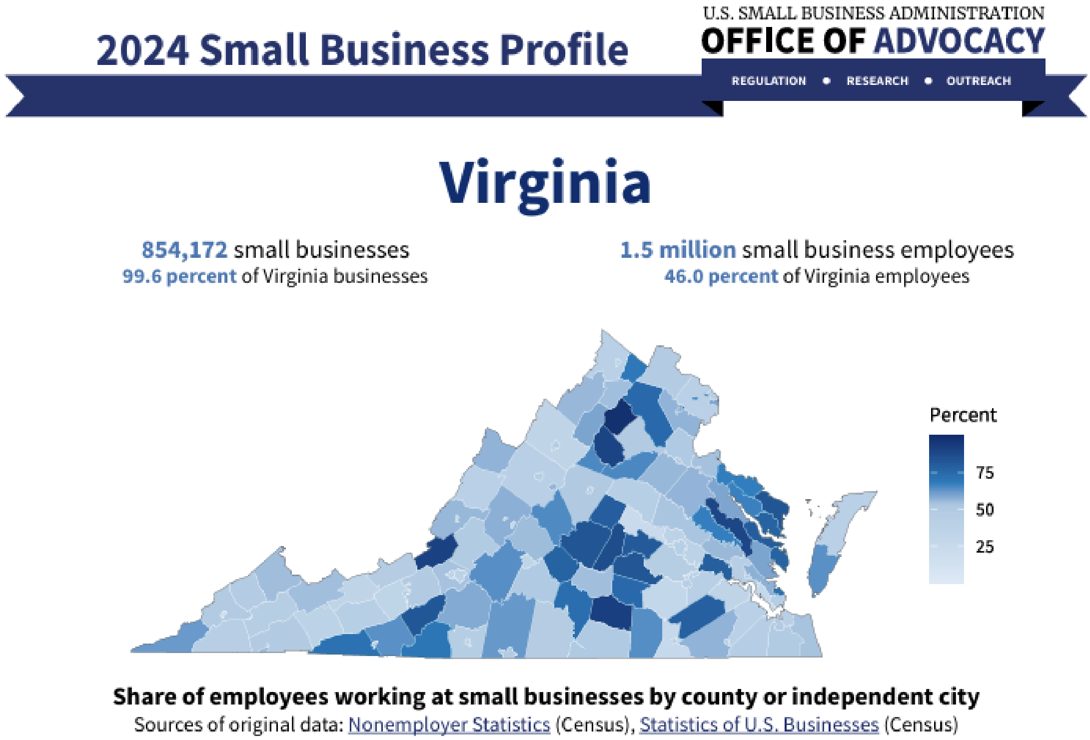


Figure 3. SBA 2024 Small Business Profile - Maryland

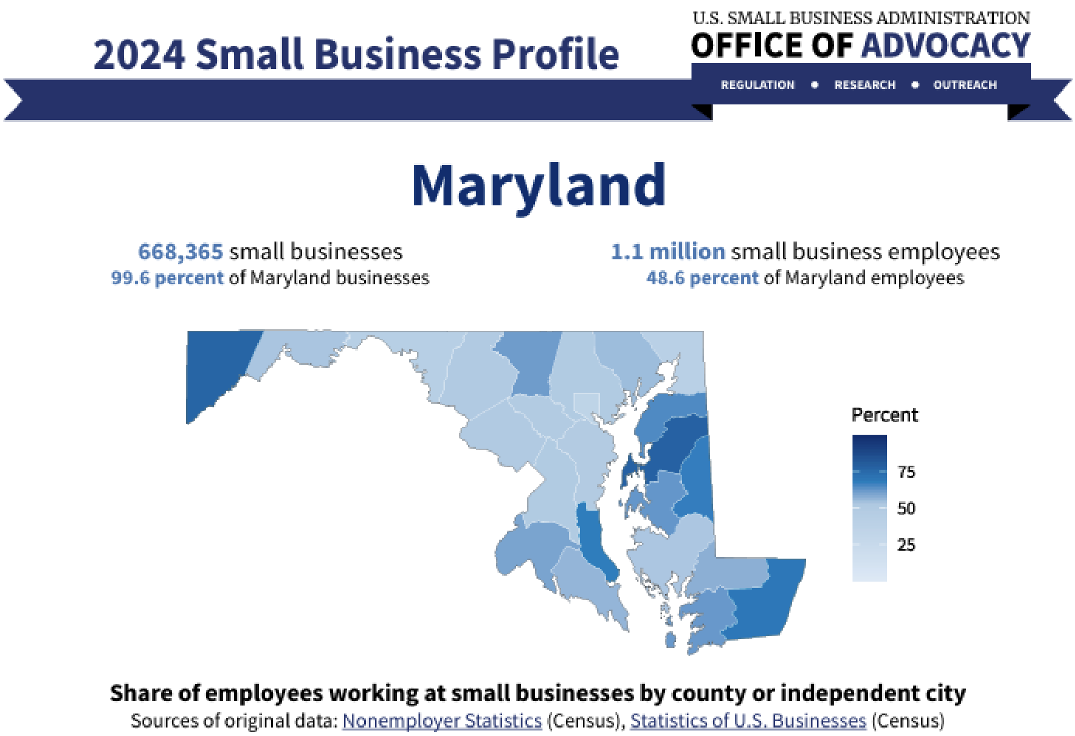
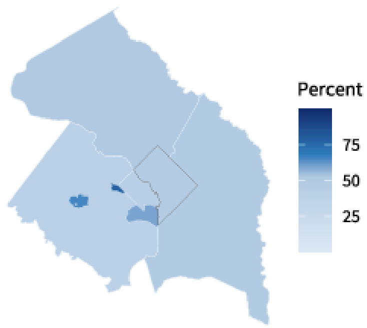


Figure 4. SBA 2024 Small Business Profile - District of Columbia

District of Columbia

78,026 small businesses
98.2 percent of DC businesses

233,078 small business employees
48.2 percent of DC employees



Share of employees working at small businesses by county, district, or independent city
Sources of original data: Nonemployer Statistics (Census), Statistics of U.S. Businesses (Census)

Figure 5. VA Sales Based Financing Disclosure Form

Eff. 10/2022

SALES-BASED FINANCING DISCLOSURE FORM

Total Amount of the Sales-Based Financing	$	**Disclosure Date:** **Recipient's Name:** **Recipient's Address:**
Fees Deducted or Withheld at Disbursement	$	
Disbursement Amount [Total Amount of the Sales-Based Financing minus (-) Fees Deducted or Withheld at Disbursement]	$	
Finance Charge	$	**Provider's Name:**
Total Repayment Amount [Disbursement Amount plus (+) Finance Charge]	$	**Provider's Address:**
Estimated Number of Payments [Number of payments expected, based on the projected sales volume, to equal the Total Repayment Amount] A reasonable range may be provided ONLY for transactions with a variable payment schedule.		**Provider's Phone Number:** **Provider's E-mail Address:**

Payment Schedule

☐ Amount of each fixed payment: $
☐ Frequency of fixed payments:

☐ Variable payment schedule, or ☐ Description of the method used to calculate the amount and frequency of each variable payment:

Method of payment:

☐ **SEE PAGE 2**

Description of All Other Potential Fees and Charges <u>NOT</u> Included in the Finance Charge	☐ **SEE PAGE 2**	
Description of Collateral Requirements or Security Interests	☐ **SEE PAGE 2**	
Broker Compensation	Is provider paying compensation directly to a broker? ☐ Yes ☐ No	If Yes, amount of compensation being paid directly to broker: $
Description of Prepayment Policies	☐ **SEE PAGE 2**	

I acknowledge that I have received a copy of this disclosure form.

Signature

Date

SALES-BASED FINANCING DISCLOSURE FORM - PAGE 2

Recipient's Name:	**Disclosure Date:**
Recipient's Address:	**Provider's Name:**

The information provided below relates to the following checked item(s):

- ☐ Variable payment schedule
- ☐ Description of the method used to calculate the amount and frequency of each variable payment
- ☐ Method of payment
- ☐ Description of all other potential fees and charges not included in the finance charge
- ☐ Description of collateral requirements or security interests
- ☐ Description of prepayment policies

I acknowledge that I have received a copy of this disclosure form.

________________________ Signature

________________ Date