

**MEMORANDUM**

**To:** The Honorable Kriselda Valderrama, Chair  
The Honorable Lorig Charkoudian, Vice Chair  
Maryland Economic Matters Committee  
230 Taylor House Office Building  
Annapolis, Maryland 21401

**From:** Katherine C. Fisher  
*Admitted in Maryland and Oregon*

**Date:** March 27, 2026

**Subject:** SB 881 - Annual Percentage Rate and Sales-Based Financing

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**I. Executive Summary**

The purpose of this memorandum is to provide information to the Economic Matters Committee in the hope that there can be a more balanced analysis of the costs and benefits of imposing an APR disclosure requirement on commercial financial products that are not closed-end loans; in particular, sales-based financing.

Sales-based financing is not a loan. Unlike other forms of financing that also are not loans (e.g., some forms of factoring and leases), sales-based financing has a unique repayment structure that is particularly incompatible with the APR metric.

This memorandum will explain that sales-based financing produces a rate of return that is highly unpredictable because the terms of repayment are based on the recipient's revenue. Even if one assumes the recipient will perform its obligations as agreed, there is no way to predict how quickly the recipient will be required to repay, or even if the recipient will be required to repay the full amount advanced. This unpredictability makes APR an unreliable tool for explaining the cost of sales-based financing. Even worse, APR masks important features that might otherwise make sales-based financing a better choice for some small businesses than a loan.

The burdens imposed on providers of sales-based financing are difficult to justify based on the supposed benefits of APR disclosures. By contrast, the primary argument that APR disclosure will benefit small business owners seems to be that polling suggests APR is popular with consumers. The presumed popularity of APR belies its inefficacy as a cost metric. Data compiled by financial regulators shows that consumers do not use APR and do not understand APR. One might wonder whether more sophisticated borrowers would do better, but this memorandum will demonstrate that common assumptions about APR are wrong. The differences in APR disclosed on competing offers that have same total dollar cost can lead to drastic overestimation of the relative difference in the true cost of those offers.

Some APR advocates claim that APR is the best metric for comparing different financing offers because it establishes a “unit cost” of financing. We explain why that claim is flawed and, instead, offer a proposal for an alternative “unit cost” metric.

## **II. Sales-based financing transactions are not loans.**

Sales-based financing produces a rate of return for the funder that is highly speculative, even where the recipient performs its obligations as agreed by the parties. Sales-based financing is typically (if not always) a precomputed obligation – meaning that the finance charge earned by the funder is fixed in advance. The cost does not increase or decrease based on how long the recipient takes to pay.<sup>1</sup>

Because sales-based financing transactions are precomputed, the fact that repayment is linked to changes in revenue means that the rate of return on any sales-based transaction is impossible to predict. Even the prospect of repayment in full is uncertain.

This uncertainty and risk is unique to sales-based financing and is the principal reason why many courts have held that sales-based financing is not a loan or, at the very least, is not subject to state usury laws that limit the contractual interest rate between the parties to a loan.

One of the bedrock principles of usury is that a transaction is not usurious if repayment is subject to a contingency that the prospect of repayment in full is placed in jeopardy. As explained in Williston on Contracts:

. . . courts have held that a loan is contingently repayable only when the lender has, by the terms of the loan, subjected itself to some greater hazard than the mere risk that the borrower might fail to repay the loan or that the security might depreciate in value. The theory is that when the lender risks the principal with the chance of either getting a greater return than lawful interest or getting nothing if the contingent event fails to occur, there is no usury since the usury laws do not forbid the taking of business chances in the employment of money.

9 Williston on Contracts § 20:18 (4th ed.) (Emphasis added).

Any transaction that qualifies as sales-based financing, as defined in SB 881, requires the provider of financing to take the risk that the recipient’s revenue will fall to \$0 and eventually absolve the recipient of any legal obligation to pay the balance of the amounts advanced or any finance charge.

## **III. Requiring APR disclosures in sales-based financing transactions places unjustifiable burdens on providers.**

Requiring a sales-based financing provider to disclose an APR based on the assumption that the sales-based financing transaction functions like a loan (i.e., with an agreed-upon payment schedule) is wholly counterfactual and misleading. The inherent variability in the term of repayment (not to mention the

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<sup>1</sup> By contrast, the finance charge on a simple interest obligation is primarily computed on the basis of outstanding principal. As principal is paid down, the amount of interest that accrues reduces over time. So early payment generally decreases the finance charge and late payment generally increases the finance charge. Precomputed transactions sometimes provide for discounts if they are prepaid in full early.

possibility that the recipient may not be obligated to repay the entire amount advanced by the provider) means that no rate of finance charge can be predicted.

Therefore, any APR metric designed for a loan will be incapable of accurately conveying the potential cost of sales-based financing because APR purports to measure the time-value of money. SB 881 would require a provider of sales-based financing to ignore the most essential feature that distinguishes sales-based financing from a loan – the fact that payments may vary based on changes in future revenue. This is particularly unjust when considering the potential for a faulty APR to be misused in ways that presumably are unintended by any disclosure law.

#### IV. APR masks the benefits of sales-based financing when compared to loans.

The assumptions required to calculate APR ignore the primary feature that could make sales-based financing more attractive than a loan; namely, the fact that a recipient has the right to adjust payments based on a fixed percentage of the recipient’s periodic revenue. If a loan and a sales-based financing offer both have the same APR and are both paid as contractually agreed, then the APR disclosed on the loan will be an accurate description of the “true” APR.<sup>2</sup> By contrast, the APR disclosed on the sales-based financing could never be expected to be equal to the “true” APR because the contractual obligation is tied to fluctuating revenue. In cases where the recipient’s payments were reduced because of declines in revenue, the “true” APR on the sales-based financing might be significantly less than the disclosed APR.

The following example demonstrates this effect:

#### **Example - Loan vs. Revenue-Based Financing**

Let’s start with a comparison of two transactions involving identical amounts of money:

|                                | <i>Loan</i> | <i>Sales-based financing</i> |
|--------------------------------|-------------|------------------------------|
| <b>Amount advanced:</b>        | \$100,000   | \$100,000                    |
| <b>Total repayment amount:</b> | \$140,000   | \$140,000                    |
| <b>Total dollar cost:</b>      | \$40,000    | \$40,000                     |

<sup>2</sup> Indeed, it would be inappropriate for the description of APR on a loan to be labeled as an “estimate” unless some essential figures need to calculate APR were not known at the time of disclosure. Marking a disclosure as an “estimate” is common in consumer finance, and Regulation Z provides clear guidance on when it is appropriate to state that a disclosure is a mere estimate. Regulation Z states that disclosures “shall reflect the terms of the legal obligation between the parties” and that a disclosure can be marked as an “estimate” only if “any information necessary for an accurate disclosure is unknown to the creditor”. See 12 CFR § 1026.17(c). In most cases, a commercial loan agreement will contain all of the information necessary to calculate APR and therefore is not “estimated” in any sense of the word. This will never be true in the case of sales-based financing because there is no fixed repayment schedule. It is debatable whether the assumptions required in order to calculate APR on a sales-based financing could rightly be described as estimates. Assuming that revenue never changes is not an “estimate”.

So far, there is nothing to distinguish one transaction from the other. Significantly, the total dollar cost is the same. The biggest differences are the repayment terms, which are described below:

|  | <b>Loan</b>  | <b>Sales-based financing</b>   |
|--|--|--|
| <b>Agreed repayment schedule:</b>                | 80 weekly payments of \$1,750  | 10% of Recipient's weekly revenue until Provider has received \$140,000.<br><br><i>Based on current estimates of Recipient's revenue, 10% of weekly revenue will be \$1,750.</i> |
| <b>Absolute or contingent obligation to pay:</b> | Obligation to pay is absolute. Failure to make a payment on time is an event of default and the entire balance can be accelerated. | Obligation to pay is contingent upon revenue. If revenue drops to \$0, the payment will too.   |

### Calculating APR

The APR calculation in SB 881 requires: (1) an amount financed and (2) a fixed schedule of payments. The amount and timing of each payment determines how long it takes for the obligation to be repaid in full. For this purpose, it is assumed that an obligor will make all payments in full and on time. Disclosure is based on the legal obligations of the obligor and not on the actual performance of the obligor.

- Loan. To calculate the APR on the loan, we would use: (1) \$100,000 advanced and (2) 80 weekly payments of \$1,750. This will produce an APR of 46%.
- Sales-based financing. To calculate the APR on the sales-based financing we have only the fact that \$100,000 will be advanced. We can't know the payment schedule. The first payment might be \$1,750 (or it might not). The amount of each of the remaining 79 payments can't be known with any certainty because the payments are adjustable based on future revenue.

APR cannot measure the cost of sales-based financing if the disclosure is based on the legal obligations of the parties. Therefore, SB 881's proposed solution is to force sales-based financing to fit the APR metric. This is done by making the provider assume that the sales-based financing will function just like the loan. So, the APR will be based on 80 weekly payments of \$1,750. Of course, this is not how the transaction works.<sup>3</sup> But this is apparently justified by the argument that APR is important as a disclosure metric, even if APR is inaccurate and unreliable as to sales-based financing. The confusion created by presenting the sales-based financing to recipients as though it is identical to a loan is, so the argument goes, a reasonable trade-off.

<sup>3</sup> To put a finer point on this, SB 881 proposes measuring loans and sales-based financing using different rules. Loans would be measured based on the terms of the legal obligation between the parties. Sales-based financing would be measured by ignoring those legal obligations (such as the obligation to adjust payments based on revenue) that are so confounding to the APR metric.

Before making up our minds about whether this trade-off is justified, let's consider a comparison showing how changes in revenue make disclosed APR (46% in the example above) differ from actual APR – as applied to loans and sales-based financing.

**Comparison - Disclosed vs. Actual APR**

|  | Change in revenue assumptions   | Disclosed APR | Actual APR (loan)   | Actual APR (sales-based financing)   |
|--|---|---------------|---|--|
| <b>Hypothetical 1 - increase in revenue after week 5</b>       | Assume revenue <u>increases</u> by 20% after week 5.  | <b>46%</b>    | <b>46%</b><br><br>The APR disclosure was accurate because the legal obligation of the borrower is to make the same payment every week.  | <b>53.7%</b><br><br>Disclosed APR was inaccurate because the one-time increase in revenue increased the weekly payment. The recipient paid \$140,000 about 12.5 weeks faster than it would have paid the loan, resulting in a higher than predicted APR. |
| <b>Hypothetical 2 - decrease in revenue after week 5</b>       | Assume revenue <u>decreases</u> by 20% after week 5.  | <b>46%</b>    | <b>46%</b><br><br>The APR disclosure was accurate because the legal obligation of the borrower is to make the same payment every week.  | <b>38%</b><br><br>Disclosed APR was inaccurate because the one-time decrease in revenue meant the recipient paid \$140,000 about 18.75 weeks longer than it would have paid the loan, resulting in a lower than predicted APR.                           |
| <b>Hypothetical 3 - revenue declines to \$0 after week 50)</b> | Assume revenue never changes until week 50. A hurricane destroys the store. The business is unable to recover and produces no more revenue after week 50. A total of \$87,500 has been paid, leaving a balance of \$52,500. | <b>46%</b>    | <b>46%</b><br><br>The APR disclosure was accurate because going out of business does not relieve the borrower of its obligation to pay. | <b>0%</b><br><br>Disclosed APR was inaccurate because a sales-based financing imposes no further obligation to pay when revenue permanently dropped to \$0. The provider only recovers \$87,500. This is less than the \$100,000 advance.                |

These hypotheticals demonstrate that even a one-time change in revenue can have a substantial impact on the actual APR of a sales-based financing but not on the actual APR of a loan. One result is that APR could make loans appear more favorable than sales-based financing because loans and sales-based financing are priced for risk. Based solely on a comparison of the different legal obligations of the obligor on a loan versus sales-based financing, the provider of sales-based financing takes more risk than the provider of loan because of the flexible payment structure. Therefore, it is anticipated that the pricing will be structured to compensate for that risk. APR focuses solely on a very specific measurement of cost and ignores the benefit of the flexible payment structure.

Of the three hypotheticals presented above, it is obvious that the sales-based financing would have been a better option than the loan. A focus on APR masks the important difference between the

repayment terms of the loan and the sales-based financing. And the only justification offered for this is a belief that APR is the best method for comparing different forms of financing.

This is a belief that has been considered, and rejected, by other policymakers.

**V. The efficacy of APR when used to compare loans does not justify its use for comparison of loans to other forms of financing.**

We understand the stated goal of APR advocates is to develop common disclosures for very disparate commercial finance products (loans, factoring, sales-based financing) and that some believe APR disclosures are the key to common disclosures. However, that approach has been considered and rejected by other policymakers. In consumer finance, APR disclosures for closed-end lending are different from APR disclosures for open-end lending and non-existent for leasing.

The Federal Reserve Board (FRB) has studied how the consumer disclosures they have developed for consumer products are used by consumers and how those disclosed impact consumer choices about credit products. One important insight is that “while the idea of using common design and information elements across financial disclosures is both appealing and potentially beneficial, the variety and complexity of financial products presents challenges for standardizing disclosures.”<sup>4</sup> Another insight from the FRB is relates to how policymakers influence the way consumers think about choice:

Disclosures have historically been intended to present “just the facts”: They should not steer the consumer in one direction or the other. However, as “choice architecture”—the idea that the way options are presented influences what people choose—has entered the policy discussion, policymakers recognize that few presentations of information may be truly neutral.

*Id.* at Page 16.

As we know, the final design of disclosure regulations for consumer financial products was not based on a common design (closed-end credit products, open-end credit products, and leasing products are all subject to different federal disclosures). This reflects that fact that a common design can impede consumer understanding. The FRB has noted:

Sometimes the transfer of learning that occurs through standardized disclosure proves beneficial; at other times, it can be confusing or potentially misleading. . . . In some cases, the [FRB] chose to use distinctly “nonstandard” language in order to highlight differences in financial products. For example, in consumer leasing disclosures, the [FRB] uses the terms “capitalized cost reduction” and “rent charge” rather than “down payment” and “finance charge” to differentiate the terms of a vehicle lease from those of a vehicle loan. Thus, while creating and maintaining consistency across disclosures for different products is beneficial, at times consumers may need to be alerted when a standard or familiar piece of information has a different meaning for another product.

*Id.* at Page 20.

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<sup>4</sup> See “Designing Disclosures to Inform Consumer Financial Decision making: Lessons Learned from Consumer Testing”, Federal Reserve Bulletin Vol. 97, No. 3 dated (August 2011) at Page 19.

In consumer finance, the APR metric is used exclusively for loans. The FRB had at one time considered, and rejected APR, for leases.<sup>5</sup> Even the APR disclosure requirements are not identical APR disclosure for a closed-end installment loan is different from the APR disclosure on an open-end loan. The APR for closed-end loans includes fees that are treated as finance charges, while the APR disclosed at account-opening for open-end credit is simply the periodic interest rate multiplied by the number of periods in a year (the corresponding annual rate).

Using APR disclosures for small business loans may be justifiable because the difference between consumer loans and business loans is largely limited to a difference in the borrower's use of the proceeds, and not a difference in the nature of the financial product. By contrast, the difference between loans and sales-based financing is significant; arguably even greater than the difference between loans and leases. Requiring sales-based financing providers to provide APR will certainly confuse some small business finance applicants into believing the product is a loan instead of sales-based financing. And by encouraging applicants to focus on APR, these applicants are steered into loan products and away from sales-based financing, when sales-based financing may be the better alternative.

**VI. There is evidence that APR disclosures on sales-based financing transactions has been misused by the courts.**

In a recent bankruptcy option (In re Greenwich Retail Group LLC, 2026 Bankr. LEXIS 417) the court mistakenly conflated the "Offer Summary" required by New York's Commercial Finance Disclosure Law with the terms of the contract memorializing a sales-based financing. The case involved, among other things, a review of the transaction to determine if the financing was, in fact, a sales-based financing or a disguised loan. In the Greenwich case, the court cited the Offer Summary (which disclosed an estimated APR of 65.25%) as evidence of what the provider would earn under the terms of the contract. As noted above, any APR disclosure on a sales-based financing masks the fact that (unlike a loan) there is no agreed-upon rate of return for the provider. The dollar amount of the finance charge in a sales-based financing is precomputed and not subject to change. The recipient's ability to reduce payments when revenue is low means the term of repayment is extended, and the rate of return is decreased. The ability of the recipient to reduce payments is tied to future reductions in revenue and therefore inherently unpredictable.

It should be noted that, under New York law, bankruptcy cannot be an event of default in a sales-based financing transaction. Therefore, absent some material breach of contract which would permit the provider to accelerate the unpaid balance, a liquidation of the recipient's business (in bankruptcy or otherwise) generally would eliminate the recipient's obligation to continue making payments. In other words, notwithstanding the APR disclosure in the Offer Summary of an APR of 62.25%, the "true" APR on the transaction could have been as low as 0%.

The court's focus on the APR seems to have been prejudicial to the provider of the sales-based financing. The court appears to have viewed APR to be more than just a disclosure, but in effect a term of the contract between the parties. And if the transaction were a loan, this view would do no harm.

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The absolute obligation to pay ensures that the lender is contractually entitled to receive a rate of return that is equivalent to the APR. By contrast, sales-based financing provides no contractual right to any particular rate of return. Upon seeing that the sales-based financing had a stated APR of 65.25%, it should be predictable that the court could mistakenly assume the sales-based financing is simply a disguised loan.

APR disclosures were intended to be used by applicants who are seeking to compare different financing offers. APR should not be used by courts to make determinations about the contractual rights of the parties to a financing transaction. And yet, the Greenwich court appears to misunderstand the role of these disclosures. By forcing sales-based finance providers to disclose an APR (which presupposes a contractual right to a specific rate of return) the sales-based finance providers are unjustifiably exposed to the risk that confused courts will wrongly apply usury law standards to these products. One could reasonably wonder whether (for advocates of APR) this is a feature and not a bug.

That an APR disclosure would even be considered in a bankruptcy case is a disturbing consequence of the New York legislature's decision to force APR disclosures upon providers sales-based financing. Understandably, providers of sales-based financing have a strong incentive to limit this misuse of APR disclosures in additional venues.

**VII. The burdens of calculating and disclosure APR are not justified by the claims that polling shows consumers want APR disclosure**

It should be no surprise that consumers who are asked if APRs are important to them routinely answer "yes". Why would anyone say no? Polling results can often vary significantly just on the basis of how polling questions are phrased and is nonscientific. With regard to the efficacy of APR, the important question is not what polling data reveals, but what actual testing of consumer behavior reveals. In 2012, the Consumer Financial Protection Bureau (the "Bureau") cited studies showing that consumers do not, in fact, use APR to making decisions about choosing a loan:

"Concerns have been raised repeatedly over the last two decades that consumers are confused by what the APR represents and do not use it for its intended purpose: to compare loans. The Board-HUD Joint Report noted that consumers generally do not understand what the APR represents or how to use it, and that some consumers mistake the APR with the interest rate. Board-HUD Joint Report at 10. Consumer testing conducted for purposes of the Board's 2009 Closed-End Proposal revealed these same problems with the APR. 74 FR at 43296. The Board tested alternative descriptions and formats for the APR, but the APR continued to confuse consumers. *Id.* The Board's consumer testing also indicated that consumers did not use the APR to compare loans but, instead, focused on the interest rate, monthly payment amount, and settlement costs when comparing loan offers."

See <https://www.federalregister.gov/d/2012-17663/p-1014> (emphasis added).

Polling of consumers may show that consumers believe that APR is an important metric for comparing offers of financing. But consumer demand for APR is not a justification for using disclosure metrics that require us to ignore important legal obligations of the parties to the transaction.

**VIII. Proposal for a true "unit cost" metric.**

A “cost-per-dollar” disclosure is a true apples-to-apples comparison using universally understood units of measurement – namely, dollars and cents. We acknowledge the primary drawback of this disclosure – cost-per-dollar does not include the timing of payments. We suggest that this drawback is outweighed by the following benefits of a cost-per-dollar disclosure:

- **Simplicity.** Cost-per-dollar would be calculated as the total cost of capital divided by the total amount financed. This formula is easy to calculate and simple to test.
- **Flexibility.** Because a cost-per-dollar disclosure does not require product-specific assumptions, cost-per-dollar would accommodate future innovation as new commercial financing products are introduced into the marketplace.
- **Comparability.** Cost-per-dollar is a true “unit cost” of capital. In much the same way that comparing the cost of groceries that are packaged in different sizes is aided by the “per ounce” unit cost disclosure, different financing offers would be easy to compare with a cost-per-dollar unit cost.<sup>6</sup>

We suggest that the above benefits of a cost-per-dollar disclosure outweigh the drawback of not including the timing of payments concept. Because the time value of money may be more complex for a business than a consumer, APR may be less helpful in the context of business finance.<sup>7</sup> For example, the time value of money for a business is impacted by more than timing of payments, and may include tax considerations (i.e., depreciation of goods obtained with financing and whether part of the financing payments are tax deductible), inflation and wage increases, and missed opportunity costs if the business does not have the funds in hand today. Perhaps the timing of payments concept in any standard disclosure cannot adequately address the time value of money for businesses.<sup>8</sup>

As you know, two states (California and New York) have included APR in their commercial financing disclosure law, and nine states (Connecticut, Florida, Georgia, Kansas, Louisiana, Missouri, Texas, Utah, and Virginia) have not. A cost-per-dollar disclosure instead of APR is a true “unit cost” that could offer a path forward for broad support.

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<sup>6</sup> Business owners use similar unit cost analysis for financial planning, such as revenue-per-unit. *See e.g.,* Amy Gallo, *A Quick Guide to Breakeven Analysis*, Harvard Business Review, July 2, 2024. <https://hbr.org/2014/07/a-quick-guide-to-breakeven-analysis>

<sup>7</sup> Social scientists have studied consumer understanding of APR for years. There appears to be no consensus that APR has aided consumers in evaluating competing offers of credit, and some studies that suggest APR actually created consumer confusion. *See, e.g.,* <https://www.federalreserve.gov/pubs/bulletin/2011/pdf/designingdisclosures2011.pdf>

<sup>8</sup> For this reason, businesses sometimes use a weighted average cost of capital calculation that includes tax considerations.