June 25, 2018

The Honorable Monique Limón, Chair
Assembly Committee on Banking and Finance
Capitol Office, Room 6031
P.O. Box 942849
Sacramento, CA 94249

Re: California Senate Bill 1235, as Amended in Assembly June 13, 2018: Oppose unless amended

Dear Chairwoman Limón:

I write on behalf of the American Financial Services Association ("AFSA")[1] to express our concerns with SB 1235. This bill would create a new set of disclosures that commercial lenders would be required to provide borrowers at the time credit is initially offered. Though AFSA members primarily offer consumer credit, our members also provide financing to commercial entities. In particular, AFSA members are regularly engaged with California's automobile dealers to provide them with the financial services, known as "floorplan" lending, necessary to enable these dealers to acquire their inventories of vehicles. AFSA is concerned that SB 1235, as currently drafted, does not adequately consider the wide range of commercial transactions, such as floorplan lending. As a result, it could inject unnecessary confusion and potential liability into standard transactions that are already well-understood by both sophisticated business parties and increase the cost of or reduce availability of commercial credit for California automobile dealers. For these reasons, I regret to inform you that AFSA must oppose SB 1235 unless it is amended.

Automobile dealers must purchase the cars that they hold for sale. Acquiring cars to stock a dealership lot requires a significant capital outlay. Dealers either do not have the funds on hand to purchase these cars or do not wish to tie up their working capital in inventory, which can take months to sell. As a result, dealers turn to floorplan lenders to finance their inventory.

Floorplan lenders provide floorplan inventory financing to automotive vehicle dealers through revolving or open-end credit lines. Under the terms of this financing, floorplan lenders finance vehicles as they are acquired by dealers. In addition, a floorplan lender may advance against vehicles already existing in a dealer's inventory. Generally, an advance is an interest-only loan until the dealer sells the particular vehicle for which the advance was made. Within a specified number of days following the sale of a vehicle, the dealer must remit the principal amount advanced for that vehicle to the floorplan lender. As a result, there is no traditional payment schedule. In addition, some lenders do not provide explicit credit limits to dealers. And for lenders that do provide explicit credit limits, these limits may be subject to change based on factors such as: the borrower's business strategy, the borrower's creditworthiness, seasonality, automobile manufacturers' production schedules, etc.

[1] Founded in 1916, the American Financial Services Association (AFSA), based in Washington, D.C., is the primary trade association for the consumer credit industry, protecting access to credit and consumer choice. AFSA members provide consumers with many kinds of credit, including direct and indirect vehicle financing, traditional installment loans, mortgages, payment cards, and retail sales finance. AFSA members do not provide payday or vehicle title loans.

Interest accrues through the date of repayment of that advance. The interest rate on floorplan financing is a floating rate, generally tied to a base rate, such as LIBOR or prime, and often with an additional increment assessed above the base rate. Accordingly, as base rates change, a dealer's interest rate also will change.

Finally, these facilities frequently do not contain a term. Instead, a floorplan financing credit line will remain open and available until either the floorplan lender or the dealer borrower elects to terminate it.

The revolving and floating rate nature of the product make disclosures that require absolute dollar calculations misleading, as the only way to make such disclosures is to base them on a number of assumptions about the dollar amount of principal that will be borrowed under the revolving facility, rate of interest, and term of financing. Ultimately, this does not provide any informational benefits to a borrower.

The following comments to SB 1235 are based on the contextual background provided above.

Section 22800(j)

22800(j) defines "recipient" as "a person who is presented a commercial financing offer…that is equal to or less than five hundred thousand dollars ($500,000)." While the $500,000 restriction may be intended to exclude more sophisticated borrowers who have larger credit facilities and who may not benefit from the disclosures, the definition may be over-broad because it captures commercial financing *offers* of $500,000 even if the particular lender and borrower already have multi-million dollar financing accommodations and annual revenues in the millions or even billions of dollars.

This $500,000 restriction may unintentionally cause lenders to halt providing these 'smaller' financing offers for fear of non-compliance. Such stoppage would result in borrowers being unable to obtain needed financing or over-borrowing to avoid the restriction while incurring additional interest charges.

Section 22802(b)(2)

22802(b)(2) requires that a lender disclose the "total amount of funds to be paid by the recipient of the commercial financing pursuant to the financing agreement, assuming all payments are made when required." For a commercial open-end credit plan, the section instructs the lender to assume "the borrower repays the commercial loan according to its original payment schedule." Floorplan financing typically does not have any "original payment schedule," and it's not clear what assumptions a lender should make to satisfy this provision. In addition, floorplan loans are often floating rate loans, meaning that the rate of interest charged the borrower may change as benchmark rates change. It is not clear what assumptions regarding interest rates a lender should make in order to satisfy the assumption, but presumably, the assumption would necessitate disclosing the rate as if it were fixed, which could mislead a borrower and would necessitate countervailing disclosures by the lender.

Section 22802(b)(4)

22802(b)(4) requires that for products with variable payments and no fixed term, a disclosure of the "estimated term of the financing product in total number of days as assumed by the provider in the underwriting process." Floorplan financing generally is of indeterminate length. The relationship is maintained as long as the parties agree to mutually maintain it. Many floorplan lenders have financing relationships that have been in place for decades. As a result, there may be no term assumed in the lender's underwriting process. Providing an assumed term may mislead a dealer borrower into believing that the borrower will have financing for the duration of the term. This will necessitate further clarifying disclosures to avoid misleading the borrower.

Section 22803

The "Estimated Annualized Cost of Capital" must be derived from information disclosed in Section 22802. The analysis above outlines why these disclosures are problematic for floorplan lenders. Utilizing assumptive data to arrive at a figure which may be used by a borrower to comparison shop could result in misleading information that may not be useful in evaluating competing financing offers and may cause a borrower to be confused about its actual financing terms.

Summary

If passed into law, Senate Bill No. 1235 would be difficult or impossible for floorplan lenders to comply with, and the required disclosures are likely to be confusing or outright misleading to borrowers. In complying with this law, floorplan lenders would be forced to create disclosures governing their disclosures. Floorplan financing and other open-end credit arrangements are structured in ways that are a bad fit for the approach taken in this Bill. The proposed disclosures will have a tendency to mislead borrowers when the credit facility involves a floating interest rate, and indeterminate term, an adjustable credit limit, an unpredictable timetable for advances, and no repayment "schedule" at all. In order to comply with this provision, a floorplan lender would be forced to make numerous assumptions that will be inconsistent with the methodology actually used by the floorplan lender to calculate interest, leading to confusion by the borrower.

For these reasons, we respectfully urge you not to move forward with this legislation as proposed. Thank you in advance for your consideration of our comments. If you have any questions or would like to discuss this further, please do not hesitate to contact me at 202-469-3181 or mkownacki@afsamail.org.

Sincerely,

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cc: Senator Steven Glazer