

## Finance Alert

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# California Commercial Financial Law Regulations About to Take Effect—What You Need to Know

The final implementing regulations for the California Commercial Financing Disclosure Law will take effect Dec. 9.

Among the industry participants subject to the Disclosure Law are nonregulated commercial financing providers (CFPs) offering commercial loans, commercial open-end credit plans, lease financings, factoring transactions, sales-based financings and asset-based lending transactions. CFPs exempt from the Disclosure Law include federal- and state-chartered banks, savings and loan associations, credit unions and trust companies.

## Disclosure Law Enacted

Earlier this year, the California Office of Administrative Law (OAL) approved the Department of Financial Protection and Innovation's (DFPI) implementing regulations for the Disclosure Law. The Disclosure Law outlines a CFP's responsibilities, disclosure and formatting requirements, how certain items such as annual percentage rates are calculated, and potential liability considerations. The disclosures are required to be made as a stand-alone document and, in general, require CFPs to disclose, depending on the type of financing being offered, the total amount of funds provided, the total dollar cost of financing, the periodic (or monthly) payment amount, the term or estimated term, the annual percentage rate, the total payment amount, a description of prepayment penalties, and—until Jan. 1, 2024—the total cost of financing expressed as an annualized rate.

Enforced by the DFPI, the Disclosure Law applies to commercial financing transactions offering \$500,000 or less to "recipients whose business is principally directed or managed from California." The law applies to parties



including commercial financing providers, financiers and brokers.

## Disclosure Regulations' Definitions

Upon passing the Disclosure Law, the California State Legislature directed the DFPI to issue implementing regulations before the law's disclosure requirements take effect on Dec. 9. The OAL approved the final disclosure [regulations](#) on June 9.

## CFP Responsibilities

The disclosure regulations attempt to cover all types of commercial financing transactions, with specified rules for six basic types, as well as a catchall category:

1. Closed-end financings
2. Commercial open-end credit plans
3. Factoring transactions
4. Sales-based financings (i.e., merchant cash advances)
5. Lease financings
6. Asset-based lending transactions
7. General (catchall) financing transactions

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## General Disclosure Requirements

As part of these transactions, CFPs' responsibilities include the following:

- Provide a copy of compliant disclosures to a broker whenever a financier provides a broker with a specific commercial financing offer.
- Maintain a copy of the evidence of transmission of the disclosures provided by a broker to the financing recipient, copies of which must be retained for at least four years following the date that the disclosure is presented to the recipient.
- Obtain a copy of the disclosures signed by the recipient prior to consummating the commercial financing.
- Develop procedures that are reasonably designed to ensure that financing recipients receive the disclosures required under the Disclosure Law at the time that a broker (or the CFP) provides a specific commercial financing offer to a recipient. These procedures may include:
  - Contractual requirements that brokers timely provide the CFP with documentation of disclosure transmissions (including the timing of transmissions) to the financing recipient
  - A process to timely investigate the facts that would give a financier reasonable notice that a broker has not provided disclosures to recipients as required by the Disclosure Law
  - A process for discontinuation of contractual or business relationships with any broker whom the financier has found to have engaged in a pattern of noncompliance
- If disclosures are provided electronically, a method for the recipient to submit an electronic signature must also be provided.

## Disclosure Formatting

The disclosure regulations impose specific column-by-column and row-by-row formatting requirements for each category of commercial financing transaction. This includes font sizes and the representation of numbers and percentages. Among these formatting requirements are:

- Text appearing in the first and second columns where those columns are not combined with other columns should be in 12- to 14-point Times New Roman font.
- Text appearing in the third column or information appearing in cells where the second and third columns are combined or information appearing in cells where the first, second and third columns are combined should be in 10- to 12-point Times New Roman font.
- The "OFFER SUMMARY" title on the disclosure page should be in 16-point Times New Roman font.

## Additional Required Disclosures

The final regulations also specify additional required disclosures when a CFP provides a disclosure—either directly to the recipient or to a broker—and the amount financed is greater than the recipient's received funds.

In these circumstances, the CFP is required to provide a second, separate document disclosure titled "Itemization of Amount Financed." This disclosure must include at minimum:

- The recipient funds, labeled as "Amount Given Directly to You."
- The amount credited to the recipient's account with the financier, labeled as "Amount Paid on Your Account with Us," followed by the account number, if applicable. The amount credited to the recipient's account may vary based on changes to the outstanding balance due on the recipient's account. However, a disclosure will be considered accurate if it is accurate at the time it is provided.
- Any amounts paid to others by the financier on the recipient's behalf, each of which must be listed on a separate line. These payees may be described using generic or other general terms and need not be further identified (e.g., a recipient's supplier or retailer, public officials or government agencies, credit reporting agencies, or insurance companies). Again, an amount disclosed may vary based on changes to the outstanding balance due in accordance with the recipient's other obligations. However, the disclosure will be considered accurate if it is accurate at the time it is provided.
- The sum of the amounts labeled as "Amount Provided to You or On Your Behalf" on the Additional Disclosure

Tables, followed by a brief explanation of how the amount was calculated (e.g., "Sum of Items 1-7").

- The prepaid finance charge, labeled as "Prepaid Finance Charge" or "Prepaid Finance Charges," followed by a description of the purpose of the charge or charges (e.g., "Brokerage Fee").
- The amount financed, labeled as "Amount Financed," followed by a brief explanation of how the amount was calculated (e.g., "Item 5 minus Item 4").

### Calculations Defined

The disclosure regulations have specific methods of calculation for certain operative terms, such as "Annual Percentage Rate" and "Finance Charge." Some of these calculations are not intuitive and are based on federal statutes. CFPs intending to create new compliance policies and procedures to satisfy the Disclosure Law should consult with their Loeb & Loeb contact for support in creating statutorily compliant commercial finance disclosures.

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