Dear Mr. Bishop and Ms. Mohapatra:

Thank you for the opportunity to provide the New York State Department of Financial Services (“the Department”) comments on Assembly Bill 10118-A/Senate Bill 5470-B, a bill passed by the legislature that requires prescriptive new disclosures in small business financing. PayPal believes in transparency and meaningful disclosures; however, there are several key areas of concern with the legislation including: APR disclosure requirements, lack of Regulation Z like tolerances, penalty provisions, and the short effective date timeframe. Based on the complexity of the bill and its vast impact to New York’s small businesses and the small business lending industry, we believe additional work is needed on the legislation. Accordingly, we urge the Department and the Administration to consider a veto of the legislation, unless amended as suggested below.

As background, PayPal is a leading online payments company, with over 345 million active user accounts globally. PayPal is also a general servicer and marketing servicer, through an arrangement with WebBank, an FDIC insured state-chartered bank, for three small business lending products: PayPal Working Capital (PPWC), PayPal Business Loan (PPBL), and LoanBuilder, A PayPal Service (LBAPS). In 2019 alone, these three products provided over $345 million in financing to more than 7,700 New York small businesses. Additionally, PayPal, in conjunction with WebBank, participated in the SBA’s Paycheck Protection Program (PPP), nationally facilitating $2.1 billion in loans for approximately 76,000 small businesses, and in New York specifically, more than 7,000 loans, equating to approximately $199 million, with an average loan size of $27,800.

These business financing products serviced by PayPal are unique and transparent products that provide fast, flexible, and fair access to credit for small businesses that otherwise may not receive funding. PPWC is primarily based on a business’ PayPal account history and is structured to be repaid through a chosen percentage of the business’ PayPal sales, with a minimum payment required every 90 days. The PPWC application and funding can take just minutes. PPBL and LBAPS are short, fixed-term loans, ranging from 13-52 weeks, with fixed weekly payments. For PPBL and LBAPS, small businesses will typically receive funding within 24-48 hours of approval. The cost for these loan products is structured as a single, fixed fee that the borrower knows in advance, without any periodic interest charges, late fees, or prepayment fees.¹

¹ See Appendix A, PayPal loan application screen shots, which include fee disclosures
PayPal has done extensive research on these lending products and the benefits they provide to small businesses, particularly those in underserved and minority communities. In our recent report, *Alternative SMB Financing: Fueling Underserved Entrepreneurs* \(^2\) there were several key findings:

- **70%** of PPWC loans were made to borrowers in the 10% of counties that lost 10 or more bank branches since the 2008 financial crisis. Also, the share of total PPWC being distributed to Banking Deserts is 2x the share of traditional SMB loans.

- **26%** of PPWC loans were made to borrowers in low-moderate income census tract businesses compared to 22% of traditional SMB loans. These same low-moderate income census tract businesses exhibited better growth rates with PPWC. In 2017, the YOY growth rate for these borrowers was 22% vs. the average SMB growth rate of 9%.

- The percentage of total PPWC loans made to borrowers in census tracts with greater than 25% African American population share is slightly higher than traditional SMB loans (13% vs. 11%). Also, this same group of borrowers is growing more quickly than the average SMB (22% vs. 9%).

- **The percentage of total PPWC loans made to female-owned businesses is 33%, while only 16% of conventional small business loan recipients are female.**

Additionally, PayPal regularly conducts surveys of our small business borrowers to ensure we continue to offer services that meet their needs. From data gathered in 2019, overall, the level of satisfaction with processes and products for PPWC and PPBL is favorable – more than 85% of respondents in almost all satisfaction categories selected a positive or very positive rating.

According to the borrowers surveyed in October 2019, **95%** of PPBL borrowers surveyed gave a positive or very positive rating to the loan’s ease of application and **94%** gave a positive or very positive rating to the time it takes to apply and receive funding.\(^3\) For borrowers surveyed on PayPal Working Capital in April 2019, **99%** of PPWC borrowers surveyed gave a positive or very positive rating to the time it takes to apply and receive funding and **85%** gave a positive or very positive rating to the loan’s repayment flexibility.\(^4\)

PayPal fully supports transparency and equal access to credit, but cautions against disclosures that may confuse borrowers. In order to preserve the tenets of fast, flexible, and fair financing, which are essential to today’s small business owners, disclosures should be both meaningful and helpful to borrowers.

**Annualized Percentage Rate Disclosures**

Assembly Bill 10118-A/Senate Bill 5470-B requires sales-based financing and closed-end commercial loans to disclose an estimated or full annual percentage rate (APR) calculation. **However, APR is a metric used in consumer loans, as required by federal Regulation Z. Including APR in this context raises concerns with the appropriateness of applying APR to commercial loans and the complexity associated with the calculation.** Commercial loans are structured differently than consumer loans and used for different purposes.

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The study is based on PayPal data analyzing PPWC, PPBL and LBAPS loans disbursed to businesses in the U.S. between October 2014 to September 2018.

\(^3\) Data Source: PayPal Business Loan (PPBL) Growth Survey of Borrowers, October 2019

\(^4\) Data Source: PayPal Working Capital (PPWC) Growth Survey of Borrowers, April 2019
APR calculations often do not accurately reflect the true cost of the loan, therefore, masking the benefit the customer would receive from the financing. Indeed, a borrower could and would often see a lower APR for a loan with a longer-term, when, in fact, the actual cost of financing could be significantly higher with a longer-term loan. According to a 2018 study commissioned by Square Capital, individuals “make more mistakes when loan costs are quoted in terms of APR rather than borrowing costs.” In fact, according to that study, individuals are 21.5% less likely to recognize the cheaper option when it is quoted as an APR.

Given the short-term nature of many business loans, providing APR as a metric can be especially misleading. Instead, a more helpful disclosure for shorter-term business loans is the “total cost of financing.” This disclosure allows small business borrowers to understand the total cost they will pay, which, in turn, allows borrowers to accurately compare lending options. As noted above and as shown in Exhibit A, PWC, PPBL and LBAPS very clearly inform a borrower of exactly how much the borrower will pay by displaying a single, fixed fee that the borrower knows before they accept a loan offer.

Additionally, a chief disadvantage of APR is its complexity. APR is among the most complicated concepts with which creditors must grapple, and generally cannot be calculated by hand or with a scientific calculator or spreadsheet. Nor can APR be represented using a simple algebraic equation. The actuarial method that almost all creditors employ to calculate APRs requires an iterative approach, where a calculation is performed again and again until a result is reached, and generally must be calculated using specialized software.

Assembly Bill 10118-A/Senate Bill 5470-B states APR shall be calculated in accordance with the federal Truth in Lending Act, Regulation Z. Regulation Z requires creditors to calculate APRs using either the so-called “actuarial” method or “U.S. Rule” method, but Regulation Z provides no guidance as to the latter. Importantly, the actuarial examples in Regulation Z are for common types of consumer loans and were not designed with commercial loans in mind. There are no examples of or guidance with respect to loans with flexible payments, which are now common in the small business loan market. PPWC is a perfect example of this type of small-business loan, where payments are made when a borrower has a sales transaction processed by PayPal.

Additionally, the complexity of calculating APRs makes such rates difficult to validate. Regulators generally check APRs using a program developed by the Office of the Comptroller of the Currency (“OCC”) called APR WIN to validate APR calculations. There is no practical way to check APRs by hand. APR WIN, however, was designed with consumer loans in mind. It would be difficult to use this tool for small business loans with higher frequency payments, like PPWC, PPBL and LBAPS.

Calculating an estimated APR for PPWC loans based on estimated daily sales volumes will be extremely difficult given the complexity of the APR calculation and the current limitations with existing APR calculation tools. The limitations of the APR tools make its calculation difficult even for PPBL and LB loans, which have set, weekly repayments.

6 Understanding Borrower Demand for Revenue-Based Loans Evidence from a Survey of Small Businesses; Authors: Natalie Bachas, David Sraer, & David Thesmar; researchers from Massachusetts Institute of Technology, Princeton University and UC Berkeley.
7 See, e.g., National Consumer Law Center, Truth in Lending, 9th ed. § 5.5.6.2.1 (“Unfortunately for both creditors and consumers, there is no easy way or simple formula to calculate the annual percentage rate using the actuarial method or the U.S. Rule.”).
Explanatory and Qualifying Language

To the extent APR is included, the bill should allow a provider to include a disclosure qualifying the APR. PPWC, PPBL and LBAPS typically have a relatively short actual or anticipated term. The longest term offered for PPBL and LBAPS is 52 weeks, and the term can be as short as 13 weeks. As noted above, providing an APR cost measure for a loan which does not have a term more than a year can be misleading. As such, the legislation should allow a provider to include a disclosure to borrowers that shorter-term loans may show a higher APR, but in fact be less costly. Additionally, where an estimated term and estimated annualized rate is shown, the legislation should also allow a clarification that estimated term and APR are estimates may vary depending on actual time to repay.

Inclusion of Regulation Z Tolerances

Although the legislation draws on concepts from the Truth in Lending Act (TILA) and Regulation Z, the legislation does not incorporate three key concepts related to disclosure accuracy that are found in TILA and Regulation Z.

First, Regulation Z provides that certain numerical disclosures that are not precisely accurate do not violate the law unless they are inaccurate by more than a specified amount (e.g., by more than 0.125 or 0.25 for an APR disclosure and by more than $5 or $10 for a finance charge).\(^\text{10}\) Second, the law provides that a creditor that has made an inaccurate disclosure may “cure” any violation resulting from such disclosure if, within 60 days of discovery and before any action is instituted against the creditor for such violation, the creditor notifies the consumer of the inaccuracy and makes any correction necessary to assure that the consumer will not be required to pay an amount in excess of the charge actually disclosed.\(^\text{11}\)

Third, the law provides for no liability if a creditor can show that a violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error.\(^\text{12}\)

If these long-standing concepts are reasonable as applied to consumer transactions, they are even more so as applied to commercial transactions. Additionally, the tolerance ranges under Regulation Z were adopted for consumer loans, which are generally smaller than business loans. As such, the bill should have more liberal tolerances. PayPal also suggests that there be no tolerance limit for inadvertent over disclosures (e.g., disclosing an annualized rate as 36% instead of 35%). A creditor would not purposefully overstate the costs of its product and, in the event it inadvertently did so, the overstated information is not likely to lead to borrower harm because the business would pay less than expected in interest and fees.

Violations/Penalties

The legislation’s penalties section (Section 812), fails to provide clarity on non-willful violations or reasonable penalty caps. Non-willful violations should be aggregated as a single violation, and the law should provide for reasonable penalty caps for both willful and non-willful violations.

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\(^{10}\) See 12 C.F.R. § 1026.22(a)(2)-(3) (setting forth APR tolerances for regular and irregular transactions, respectively); 12 C.F.R. § 1026.18(d)(2) (establishing finance charge tolerances for non-mortgage consumer transactions equal to $5 where amount financed of $1,000 or less and $10 for transactions involving an amount financed of more than $1,000).

\(^{11}\) See 15 U.S.C. § 1640(b).

\(^{12}\) See 15 U.S.C. § 1640(c) (“Examples of a bona fide error include, but are not limited to, clerical, calculation, computer malfunction and programing, and printing errors...”).
**Effective Date / Implementation Timeline**

Importantly, the legislation’s effective date of 180 days from signature is extremely problematic. The short timeframe does not seem adequate for the Department to conduct a regulatory comment and approval process and to allow providers to make the complex systemic and operational changes required for compliance with new regulations and disclosures of this complex and de novo nature. **We would recommend lengthening the effective date to a minimum of 500 days.**

**In conclusion,** PayPal provides innovative solutions with a goal of democratizing financial services and helping small businesses grow. A complex regulatory framework can impact the ability for the market to continue to innovate and grow, which can be especially detrimental during the current economic climate where access to capital is both limited and essential for many small businesses.

We urge the Department to consider the issues identified above as it conducts an analysis of the legislation’s impacts to small businesses and the small business lending industry. **Additionally, given the complexities of the legislation and its impact across a vast array of small business loan products,** we recommend the Administration consider a veto of AB 10118-A/SB 5460-B, unless amended to address the concerns outlined above.

Thank you for considering PayPal’s comments on AB 10118-A/SB 5470-B, we would be happy to continue a dialogue on the legislation with the Department and answer any questions you may have.

Sincerely,

Bernardo Martinez
Vice President, Global Merchant Lending
Exhibit A (as of September 1, 2020):
PayPal Working Capital and PayPal Business Loan Fee Disclosure