

Date of Hearing: April 26, 2022

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT, AND THE ECONOMY

Sabrina Cervantes, Chair

AB 2314 (Petrie-Norris) – As Amended April 20, 2022

SUBJECT: State-guaranteed commercial financial products for small businesses: Small Business Expansion Fund and Capital Access Loan Program

POLICY FRAME: California is set to receive nearly \$1.2 billion in federal Small Business Credit Initiative Act of 2010 (SSBCI) funding. These funds are intended to be used by the state to expand access to capital (debt and equity), promote economic resiliency, and create new jobs and economic opportunities.

California's application to the US Treasury proposes to divide these funds among three existing credit enhancement programs and a new venture program as follows: \$390.9 million to the existing Small Business Loan Guarantee Program; \$472.7 million to the existing California Capital Access Collateral Support Program; \$118.1 million to the existing California Capital Access Loss Reserve Program; and \$200 million to a new venture fund.

AB 2314 sets fair lending standards for privately issued loans that receive SSBCI-funded credit enhancements. These standards generally align with those set in the Responsible Business Lending Coalition's Small Business Borrowers' Bill of Rights, which they described as the first cross-sector consensus on the rights of small businesses-owners when accessing debt capital.

The analysis includes information on the SSBCI, the joint legislative hearing on the state's use of the SSBCI in creating a more inclusive economy, the SSBCI-funded credit enhancement programs, Small Business Borrowers' Bill of Rights, and related legislation. This bill was previously heard in the Assembly Committee on Banking and Finance and passed the committee on a 12 to 0 vote. There is no known opposition to this bill. Suggested amendments are included in Comment 11.

SUMMARY: AB 2314 requires all loans which receive a loan guarantee issued under the state's Small Business Loan Guarantee Program (Guarantee Program) or are enrolled in the California Capital Access Program (CalCAP) to meet specified fair lending practices, as specified, if the funding used to back those credit enhancements are moneys received by the state from the federal SSSBCI. Specifically, **this bill:**

- 1) Makes findings and declarations:
 - a) That the integrity of small business lending programs are of paramount importance to California's small business owners. Fostering a healthy small business lending marketplace will encourage the equitable recovery of established businesses and foster new small business creation.
 - b) There are 4.1 million small businesses in California. Small business owners employ roughly one-half of the private sector workforce and, since the Great Recession, have been the largest drivers of new job growth in our country. Despite these facts, small business owners struggle to access capital from traditional lending institutions like banks and credit unions. The commercial and industrial lending index dropped below zero percent late in 2020 and continued to be below -10% in September 2021. After the Great Recession, bank lending under \$250,000 declined significantly.

- c) New small business startups are rapidly growing. The United States Census Bureau's data on new firm formations shows that new business applications grew by almost 2 million between 2019 and 2021, a higher rate than ever before. This is especially true for non-White business owners. After experiencing the largest number of small business closures in April 2020, the number of Black and Latino-owned firms was significantly higher in September 2021 than in February 2020.
 - d) As a result, many small business owners turn to online lending as they struggle to find the capital they need in order to grow and expand. Financial products that allow small businesses to access hard-to-obtain capital often lack transparency, and recent research by the Federal Reserve concluded Black and Hispanic entrepreneurs are twice as likely to be affected by "potentially higher-cost and less-transparent credit products."
 - e) A study by Accion Opportunity Fund demonstrates that California small business owners take out online loans at an average Annual Percentage Rate of 94%. Many terms or conditions are not made clear to business owners, like products that come with hidden fees and obscure rates. Most small business owners cannot afford to make these mistakes.
 - f) Therefore, lenders participating in state lending programs funded by taxpayer dollars should use fully transparent and fair lending practices to ensure that small business borrowers can access the capital they need in order to grow and expand their businesses.
- 2) Requires loan guarantees issued by the Small Business Finance Center at the California Economic Development and Infrastructure Bank (IBank) using SSBCI funds to be fully transparent and meet specified fair lending practices. These requirements include all of the following conditions:
- a) The guaranteed loan shall not require the borrower to sign a confession of judgment, as specified.
 - b) The guaranteed loan shall not be refinanced or renewed, nor shall it be used to refinance or renew another loan, if the new loan to refinance or renew includes charges, as defined, to pay off the balance of the previous loan.
 - c) The final payoff amount of the guaranteed loan shall not vary based upon the source of the funds used to make the final payoff.
 - d) The terms of the guaranteed loan shall consider repayment funds from a third party as equivalent to funds from the borrower.
 - e) The guaranteed loan repayment information shall be sent to a commercial credit reporting agency, as defined, and credit data shall be consulted when underwriting the guaranteed loan.
 - f) The guaranteed loan's borrower and any guarantors shall be informed if the financial institution or corporation intends to report guaranteed loan repayment performance to a commercial credit reporting agency if default occurs.
 - g) The guaranteed loan shall follow a schedule of conditions concerning hidden payment charges, as follows:
 - i) The guaranteed loan shall disclose financing charges other than interest accrued since the last payment as "prepayment charges."
 - ii) The guaranteed loan shall disclose any additional charges or fees added in the case of prepayment as "prepayment penalties."
 - iii) The guaranteed loan shall disclose potential prepayment charges and penalties in any loan offer summary.

- iv) The guaranteed loan shall disclose actual prepayment charges and penalties at the time of prepayment.
 - h) The guaranteed loan shall be given to a borrower that can afford the loan, or that has a credible path to profitability, meaning that the firm has a debt-service coverage ratio of greater than 1.00.
 - i) The guaranteed loan shall be given to a borrower that can afford the loan, or that has a credible path to profitability if the financial institution received repayment directly from the borrower's gross receipts, such as through credit cards, payments process, or daily payments, that prevent the borrower from paying for operating expenses first.
- 3) Prohibits certain financial institutions from participating in CalCAP, administered by the California Pollution Control Financing Authority (CPCFA), when the state's portion of the loss reserve account is funded by moneys derived from the federal SSBCI. These requirements include all of the following conditions:
- a) The financial institution shall not require the borrower of the qualified loan to sign a confession of judgment, as defined.
 - b) The financial institution shall not refinance or renew a qualified loan, nor shall it use a qualified loan to refinance or renew another loan, if the new loan to refinance or renew includes charges, as defined, to pay off the balance of the previous loan.
 - c) The financial institution may not provide the information required for prepayment beyond two days from the date upon which the borrower requests to prepay or refinance a loan.
 - d) The financial institution shall not vary the final payoff amount of the guaranteed loan based upon the source of the funds used to make the final payoff.
 - e) The financial institution shall consider repayment funds from a third party as equivalent to funds from the borrower.
 - f) The financial institution shall send repayment information to a commercial credit reporting agency, as defined in subdivision (b) of Section 1785.42 of the Civil Code, and credit data shall be consulted when underwriting the guaranteed loan.
 - g) The financial institution shall inform the borrower and any guarantors if it intends to report guaranteed loan repayment performance to a commercial credit reporting agency if default occurs.
 - h) The financial institution shall ensure that the borrower can afford the loan or that it has a credible path to profitability, meaning that the borrower has a debt service coverage ratio greater than 1.00.
 - i) The financial institution shall ensure that the borrower can afford the loan or that it has a credible path to profitability if the financial institution receives repayment directly from the qualified loan's borrower's gross receipts, such as through credit card, payments processing, or daily payments, that prevents that qualified loan's borrower from paying for operating expenses first.
 - j) The financial institution shall follow a schedule of conditions concerning hidden payment charges, as follows:
 - i) The qualified loan shall disclose financing charges other than interest accrued since the last payment as prepayment charges.
 - ii) The qualified loan shall disclose any additional charges or fees added in the case of prepayment as prepayment penalties.

- iii) The qualified loan shall disclose potential prepayment charges and penalties in any loan offer summary.
- iv) The qualified loan shall disclose actual prepayment charges and penalties at the time of prepayment.

EXISTING LAW:

- 1) Establishes the Governor's Office of Business and Economic Development (GO-Biz) within the Governor's Office for the purpose of serving as the lead state entity for economic strategy and marketing of California on issues relating to business development, private sector investment, and economic growth.
- 2) Establishes the IBank within GO-Biz and authorizes it to undertake a variety of infrastructure-related financial activities, including, but not limited to, the administration of the Infrastructure State Revolving Fund (ISRF), the oversight of the Small Business Finance Center, and the issuance of tax-exempt and taxable revenue bonds.
- 3) Establishes the Small Business Finance Center within the IBank for the purpose of offering a range of financial capital to small businesses, including direct loans, loan guarantees, and bond insurance. Program delivery is provided through state-designated small business financial development corporations (FDCs). FDCs are prohibited from issuing a guarantee unless it determines the following conditions are satisfied:
 - a) There is a low probability that the loan being guaranteed would be granted by a financial company or financial institution under reasonable terms and conditions and the borrower has demonstrated a reasonable prospect of repayment.
 - b) The loan proceeds will be used exclusively within California.
 - c) The loan qualifies as a small business loan or an employment incentive loan.
 - d) The borrower has a minimum equity interest in the business as determined by the directives and requirements.
 - e) The jobs generated or retained demonstrate reasonable conformance to any directives and requirements specifying employment criteria.
- 4) Establishes the CPCFA, provides the authority with specified powers and duties, and authorizes it to approve financing for pollution control projects and facilities, administer a loss reserve program to serve the credit needs of small businesses, and provide grants and loans to remediate brownfields, among other activities.
- 5) Establishes CalCAP for the purpose of providing a small business loss reserve account program through participating financial institutions. In implementing the program, CPCFA is authorized to establish a loss reserve account for each financial institution with which the authority makes a contract. The loss reserve account consists of fees paid by borrowers, the financial institution, and moneys transferred to the account from CPCFA.

FISCAL EFFECT: Unknown

COMMENTS & CONTEXT:

- 1) **Joint Hearing – Member Priorities:** On March 29, 2022, the Assembly Budget Subcommittee on State Administration and the Assembly Committee on Jobs, Economic Development, and the Economy, held a [joint informational hearing](#) on the state’s implementation of SSBCI and its potential contribution to a more inclusive economic recovery from the COVID-19 pandemic.

During the course of the hearing, the Members heard from the State Treasurer, the Legislative Analyst’s Office, IBank, and CPCFA, as well as stakeholders with professional expertise on the needs of small businesses and the barriers they are currently facing to access capital.

Among other issues and recommendations discussed, stakeholders emphasized the need to consider new ways of connecting with those small business owners who have been most impacted by the pandemic and have historically faced barriers to accessing traditional lending programs. In particular, Members noted the importance of SSBCI funded program reaching undercapitalized small business owners in rural areas, as well as women-business owners and business-owners of color.

The federal Payment Protection Program (PPP) was cited as an example of government intention, which was not backed up by program outcomes. While the US Congress intended that the US Small Business Administration takes steps to ensure PPP loans prioritized small businesses in “underserved” markets, a term that includes low-income communities, rural areas and businesses owned by people of color, women and veterans,” the delivery system and other program requirements which prioritized speed resulted in underserved markets received comparatively few loans.

“(P)(iv) Sense of the senate.--It is the sense of the Senate that the Administrator should issue guidance to lenders and agents to ensure that the processing and disbursement of covered loans prioritizes small business concerns and entities in underserved and rural markets, including veterans and members of the military community, small business concerns owned and controlled by socially and economically disadvantaged individuals (as defined in section 8(d)(3)(C)), women, and businesses in operation for less than 2 years.” [*Section 1102, of Public Law 116-136*]

In response to the hearing, Members called for the establishment of a written outreach and technical assistance strategy, as well as making changes to existing small business lending programs to best meet the current needs of all California small businesses. This includes small business owners who face documented barriers to accessing capital, whether those barriers be geographically or demographically expressed.

- 2) **The Small Business Borrowers' Bill of Rights:** The Responsible Business Lending Coalition developed the [Small Business Borrowers' Bill of Rights](#) in 2015 to address the emergence of predatory practices in the small business lending market. Designed to foster transparency and accountability, there are six core principles to the Small Business Borrowers Bill of Rights, which are augmented by a set of specific practices that are required of lenders and brokers to comply with these rights. According to the Aspen Institute website, on April 5, 2022, there are more than 90 organizations who have joined as signatories or endorsers. Their six core principles are:

- The right to transparent pricing and terms
- The right to non-abusive [financial] products
- The right to responsible underwriting
- The right to fair treatment from brokers

- The right to inclusive credit access
- The right to fair collection practices

The Small Business Borrowers' Bill of Rights also drives public policy and has been adopted in a number of states, including Arizona, New York, and California. In California, the transparent pricing and term standards were included in SB 1235 (Glazer) in 2018. Among other provisions, the bill required disclosure to the borrower of the total amount of funds provided; total dollar cost of financing; the loan term or estimated term; the method, frequency, and amount of payments; a description of prepayment policies; and the total cost of the financing, as specified. The requirements of SB 1235 do not apply to all financial institutions, depository institutions; lenders regulated under the federal Farm Credit Act; and commercial financing transactions secured by real property, among others are excluded. The Department of Financial Protection and Innovation is still in the process of finalizing its rule to reflect SB 1235.

While not all items in the Small Business Borrowers Bill of Rights are included in AB 2314, the bill incorporates a number of standards into the loan structure requirements of the Small Business Loan Guarantee Program at the IBanks' Small Business Finance Center and the participating lender requirements for CalCAP administered through the CPCFA. The following, lifted directly from the [webpage](#) of the Responsible Business Lending Coalition, are concepts found in this bill:

- ***Alignment of Interests:*** Lenders who receive repayment directly from the borrower's gross sales must also verify, through documents, data from third parties, and/or due diligence, that the borrower can repay all debt and remain profitable, or that it has a credible path to profitability. Lenders should not make loans that the borrower cannot truly afford, even if the lender can find a way to be repaid."
- ***Right-sized Financing:*** Size loans to meet the borrower's need rather than maximize the lender's or broker/lead generator's revenue. Seek to offer the borrower the size of loan that they need, rather than offering the largest amount they could qualify for."
- ***Responsible Credit Reporting:*** Report loan repayment information to major credit bureaus and consult credit data when underwriting a loan. Such reporting enables other lenders to responsibly underwrite the borrower and helps the borrower build a credit profile that may facilitate access to more affordable loans in the future. Lenders must inform the borrower and any guarantors if they intend to report loan repayment performance to guarantors' credit bureaus only in certain circumstances, such as after a default.
- ***No Hidden Prepayment Charges:*** If, in the event of prepayment, the borrower will be required to pay financing charges other than interest accrued since the last payment, disclose these charges as "prepayment charges." Also disclose any additional charges or fees added in the case of prepayment as "prepayment penalties." Disclose (a) the potential amount of these prepayment charges and penalties in any loan offer summaries, and (b) the actual prepayment charge and penalties at the time of any prepayment. In the case of financing with payments that vary as a percentage of the borrower's sales, a payoff event is considered prepayment if the borrower states the intent to pay off the financing or in the event of refinancing.
- ***Fair Prepayment:*** If a borrower requests to prepay or refinance a loan, provide any information required for prepayment within two business days of the borrower's request. To enable small businesses to access the most appropriate financing, the final payoff amount should not vary based on the source of funds used for payoff, funds from a third-party should be considered equivalent to funds from the borrower.

The Responsible Business Lending Coalition is monitoring SSBCI guidance and released that the Coalition “is encouraged by Treasury’s incorporation of small business borrower protections in its program guidelines—many of which draw from the coalition’s recommendations to the agency, and, more specifically, the Small Business Borrowers’ Bill of Rights.”

Several areas of the SSBCI guidance were highlighted by the Responsible Business Lending Coalition’s announcement, including the requirement that “SSBCI-supported transactions must include ‘disclosure by the lender or investor of all key terms in an easy-to-understand manner.’” The RBLC recommends disclosing the annual percentage rate in addition to the loan or investment amount, payment obligation and schedule, and any fees or additional costs.

AB 2314 proposes to further incorporate these transparency and fair lending standards into the state’s largest credit enhancement programs that are slated to receive SSBCI funding.

- 3) **SSBCI Fair Lending Practices:** The SSBCI guidelines provide some clear direction on the importance of transparency and fair lending practices.

As noted above, the SSBCI regulation states that “SSBCI-supported transactions must include disclosure by the lender of all key terms in an easy-to-understand manner.” Examples of the type of disclosures covered by this rule include the loan amount, payment obligation and schedule, and any fees or extra costs. [*Subsection (g) Disclosure of Terms, Section IX. Other SSBCI Program Requirements*]

There are also very specific fair lending regulations, two of which are in AB 2314, including the following:

- **Confession of Judgement:** SSBCI-supported transactions are prohibited from including confessions of judgment. “A confession of judgment is usually a contractual clause in which the debtor agrees to allow a creditor, upon the nonoccurrence of a payment, to obtain a judgment against the debtor, often without advanced notice or a hearing.” [*Subsection (f) Minimum National Customer Protection Standards, Section IX. Other SSBCI Program Requirements*]
- **Double Dipping:** SSBCI-supported transactions are prohibited from including prepayment or “double-dipping” fees. “Double dipping” occurs when a lender issues new credit to refinance prior credit without forgiving a portion of the fee already paid and results in the borrower paying a fee on top of a fee. [*Subsection (f) Minimum National Customer Protection Standards, Section IX. Other SSBCI Program Requirements*]
- **Interest Rates:** SSBCI regulation sets the maximum interest rate that may be charged on loans receiving SSBCI funding to not exceed the National Credit Union Administration’s (NCUA) interest rate ceiling for loans made by federal credit unions, as specified. The US Treasury noted in the regulation that in choosing to adopt the “NCUA interest rate ceiling, Treasury aims to ensure that small businesses that participate in SSBCI receive loans that are economically beneficial to them. [*Subsection (f) Minimum National Customer Protection Standards, Section IX. Other SSBCI Program Requirements*]

In addition, Section IX, Other SSBCI Program Requirements, states that SSBCI disclosure requirements are to be considered a “minimum standard” and that these standards should not be viewed as superseding other disclosure requirements as set in federal and state laws and regulations.

- 4) **CalCap's Lender Participation Model:** CalCAP is a loss reserve program that is intended to provide flexibility to lenders to use their own underwriting criteria and set their own terms. A concern was raised that AB 2314 placed inappropriate terms and conditions on lenders and required CPCFA to independently assess the creditworthiness of a proposed enrolled bill.

The author has noted that she is in discussions with the Office of the State Treasurers, which Chairs the CPCFA, to modify the requirements of the bill to better align within the CalCAP construct. To assist in advancing this dialogue, the following is a summary of the existing program criteria and existing CPCFA authority to engage with participating lenders.

- **CalCAP Regulation (Section 8071 – Application by Financial Institution):** A financial institution seeking to participate in CalCAP is required to complete an application and be approved prior to being listed as a CalCAP lender and enrolling loans in CalCAP. The application includes basic information about the financial institution, including the name, address, and disclosure of its capital resources. The regulation also requires disclosure of specific information relative to the financial institution's operations, including, but not limited to:
 - Certification that the applicant financial institution is not subject to a cease and desist order or other regulatory sanction which would impair its ability to participate in the Program.
 - A description of the board of directors, including their race, ethnicity, and gender.
 - The financial institution's rating is from a nationally recognized credit rating agency which assesses the financial soundness and stability of financial institutions.
 - A statement that the financial institution agrees to follow CalCAP procedures, share annual audited financial statements, and permit an audit of any of its records relating to CalCAP enrolled loans, and supply such other information concerning CalCAP enrolled loans as requested by the executive director of CPCFA.

Upon receipt of a completed application, the executive director reviews and is authorized to determine whether additional information is required, or whether the application is sufficient to permit the applicant to participate in CalCAP. The statutory authority for these requirements is cited as Sections 44520, 44559.2, and 44559.5(f) of the Health and Safety Code.

- **CalCAP Regulation (Section 8072 - Loan Enrollment):** Although CPCFA regulations provide that the specific terms of the loan, including interest rates, fees, and other conditions, are determined by the agreement between the financial institution and the borrower, CPCFA has the authority and requires the financial institution to provide very specific information regarding every enrolled loan. This includes, but is not limited to the amount and term of the loan, the intended use of the proceeds of the loan, and whether the loan is secured or a refinance. The participating financial institution is also required to disclose the following:
 - The agreed amount of the fees payable by the borrower and the financial institution.
 - Confirmation that the financial institution notified the borrower if the financial institution's share of the fees for the loan has been paid by the borrower.
 - The interest rate applicable to the loan.
 - Whether the lending activities of the financial Institution are subject to any applicable safety and soundness standards as set forth in applicable federal banking regulations.

- Confirmation that the financial institution has validated that the borrower has secured or made an application for all applicable licenses or permits needed to conduct business.
- The loan is not a refinance of a loan previously made to the borrower to the extent that the outstanding balance is not increased.
- Confirmation that the financial institution has provided the borrower with the Authority's privacy notice, consistent with the California Information Practices Act,
- Obtain written certification from the Borrower that the loan is for a business purpose, not be used to pay delinquent federal or state income taxes, or purchase ownership interest in the business.

The Executive Director is authorized to review the financial institution's application for enrollment in advance of the making of the loan and notify the institution whether such loan meets CalCAP's requirements. The financial institution is required to keep CPCFA apprized of any material changes to the terms of an enrolled loan, and loans can be disqualified from program participation after being enrolled.

In summary, CPCFA already has many controls over which lenders are allowed to participate, the authority to audit and ask questions regarding the loss reserve account, and may even dis-enroll a loan or terminate a financial institution from participation in CalCAP.

One path forward is to clearly distinguish these new SSBCI-related standards from the negotiable terms and conditions of a loan that receives a credit enhancement with public funds. These are not loan terms, but rather a guardrail between fair and predatory small business lending.

- 5) **The Small Business Loan Guarantee Program (SBLGP):** In providing a general comment on the concept of adding loan conditions to SSBCI-funded credit enhancements, GO-Biz noted that new lender restrictions which might deter some lenders from participating those programs, which could ultimately impair the ability of the state to deploy SSBCI funds.

To assist in advancing the discussion of predatory lending protections versus the expedient use of the SSBCI funds, the following is a summary of the existing process used by FDCs to review and approve individual loans under the state's SBLGP.

- ***Guarantee Term and Procedures (Sections 5001 and 5002 of Directives and Requirements):*** Each lender applying for a guarantee under the SBLGP is required to submit a completed Borrower application to the FDC. Prior to the execution of the guarantee, the loan committee of the FDC is required to review application to ensure that it meets program requirements. Each guarantee application is required to approved through the adoption of a resolution by the FDC's board of directors. The CDS board may delegate approval authority to the loan committee, as specified. The terms and conditions set out in the resolution approving the resolutions must be consistent with the terms and conditions of the guarantee and including, among other things:
 - A provisions that the lender has not engaged, and will not engage, in fraudulent or negligent practices in connection with the Borrower, Guarantee, the Loan or the related loan agreement.
 - The terms of the guarantee, including the time period, percent coverage of the loan amount, fees, and default provisions.

- An agreement by the lender to abide by binding arbitration by the American Arbitration Association in the event that either the Corporation or IBank denies the requested Demand.
- An acknowledgment by the Lender that in the event of a Demand, the Lender will allow a bank examiner at the California Department of Business Oversight, or other independent auditor selected by the Corporation, to examine the Lender's Loan files.
- Confirmation that the owner(s) of the business receiving a Loan guaranteed under the SBLGP have at least \$1.00 of equity interest in the business at the time of the Loan. This minimal Directive and Requirement is intended to promote those businesses that may be under-capitalized yet have been deemed creditworthy, due to its other attributes, by a Lender.
- ***Guarantee Demand Procedures (Section 5003 of Directives and Requirements):*** In the case of a default, the lender is authorized to file a demand for payment to cover the unpaid Loan principal and interest, pursuant to a specified procedure. The procedure includes, but is not limited to all of the following:
 - Providing proof to the Corporation that the Borrower is in Default under the applicable loan agreement and the lender has delivered to both the borrower and the FDC notice of the delinquency, as specified.
 - Within 10 days of the demand being filed with the FDC, the FDC is required to contract with the California Department of Business Oversight or an independent auditor to conduct an investigation to determine whether the lender complied with the terms of the guarantee, and to issue a report to the FDC.
 - The Directives and Requirements state the report is required to include a number of specified things. This includes, but is not limited to:
 - Whether the loan agreement is consistent with the terms and conditions in the guarantee.
 - Whether all collateral for the loan and guarantee have been perfected and maintained.
 - Whether the Lender complied with the procedures for making a Demand, as specified.
 - In a section entitled “Loan Information” the report is required to include specific information “obtained solely from a review of Lender files” that includes a description of the Borrower's business and a discussion as to whether the Lender files contain any reference to matters material to borrower's compliance with any environmental laws or regulations.
- ***SSBCI Compliance:*** To ensure that all applicable requirements were followed during the first SSBCI funding round, the Directives and Requirements were amended to state: “Corporations shall adhere to the State Small Business Credit Initiative (SSBCI) rules and guidance when supporting a guarantee with SSBCI federal funds. The rules and guidance include, but are not limited to, the following resources; the Small Business Jobs Act of 2010, the SSBCI Allocation Agreement for Participating States dated February 17, 2011 between the United States Department of the Treasury and the State of California, as amended from time to time, SSBCI Policy Guidance, National Standards for Compliance and Oversight, the SSBCI F.A.Q’s, and the FDC Policy Manual.”

In summary, it appears the FDCs have a sufficiently robust process currently in place to include fair lending practices in their consideration of a loan guarantee application. Especially since many of these requirements are either explicitly or implicitly provided for under SSBCI.

- 6) **California's Use of Round One - Federal SSBCI Funds:** In 2011, California received a significant allocation of federal funds through the SSBCI, a program established under the federal Small Business Jobs Act of 2010. Under the initial federal Allocation Agreement, \$168.4 million was divided equally between the CalCAP for Small Business program administered through CPCFA and the Small Business Loan Guarantee Program administered through the Business, Transportation, and Housing Agency (BTH) and later the IBank under the Governor's Reorganization Plan GRP2.

Receipt of these funds was very timely as debt markets were frozen, and state resources were very limited for these two small business credit enhancement programs. In fact, both CPCFA and BTH were short on revenues to operate their programs and had received General Fund appropriations in 2010, with \$6 million being approved for CalCAP and \$20 million for the Small Business Loan Guarantee Program [AB 1632 (*Budget*), Chapter 731, *Statutes of 2010*]. Unfortunately for small business borrowers, BTH's \$20 million budget augmentation was eliminated in the following year's budget.

Due to federal accounting practices and slight variations in federal SSBCI loss reserve and guarantee program requirements, CPCFA and the IBank each established new reserve accounts and adopted new federal versions of their programs. Once CPCFA and the IBank received the federal funds, the program priorities for each of the programs were to use the federal funds first and leave the state funds for either nonconforming loans or use when the federal moneys had been exhausted.

Over the course of the six program years (2011 to 2017), the state amended the federal Allocation Agreement several times. In the latter years, CPCFA sought authorization to administer a third credit enhancement program, a Collateral Support Program. CPCFA used the federal funds as follows: Loss Reserve Program (\$20 million) and a Collateral Support Program (\$65 million).

According to the Legislative Analyst's Office (LAO), between 2010 and 2016, this SSBCI funding supported 10,286 new loans, and about 40% of the dollar amount of these loans was made to businesses in low-and-moderate-income communities.

The federal Allocation Agreement expired in March 2017. Both CPCFA and the IBank report that all federal funds have been expended or allocated, meaning that as these moneys become unencumbered from their current loans, the moneys can be re-deployed. As an example, funds in the Collateral Support Program could be used to continue enrolling loans under the CalCAP for Small Business program or used to fill a different small business financing gap.

- 7) **California's Use of Round Two - Federal SSBCI Funds:** The American Rescue Plan Act of 2021 included \$10 billion for the reauthorization of the State Small Business Credit Initiative. California anticipates receiving approximately \$1.8 billion in federal SSBCI funding. *Chart 1* outlines California's anticipated federal SSBCI funding.

Federal law required each application to include detailed information on how SSBCI funds will provide access to capital for small businesses in underserved communities and to business owners who are from groups who meet the definition of socially and economically disadvantaged individuals, also referred to as SEDI. According to the SSBCI Guidelines:

- A “Socially and economically disadvantaged individual” means an individual who is a socially disadvantaged individual or an economically disadvantaged individual, as defined in the Small Business Act.
- “Underserved communities” mean small businesses located in low- and moderate-income, minority, and other underserved communities, including women- and minority-owned small businesses.
- “Treasury encourages states to consider the following areas when including plans regarding ‘other underserved communities’ in their report: rural communities; communities undergoing economic transitions, including communities impacted by the shift towards a net-zero economy or deindustrialization; and communities surrounding Minority-Serving Institutions.”

Under the SEDI incentive formula, California could receive up to \$99.8 million for expending 48.87% of SSBCI Capital funds in SEDI eligible businesses during the first tranche of SSBCI deployment.

States and tribal governments will receive SSBCI funds from the US Treasury in three tranches. In order to access the next tranche of funding, the state or tribal government must demonstrate that at least 80% of the current tranche of funding has been encumbered and/or used. To facilitate the drawing down of federal funding, the IBank and CPCFA have stated that they will have an MOU in place to enhance their ability to transfer moneys between programs.

Chart 1 - California’s Estimated SSBCI Funding*		
Categories of Funding	Funding Available	
Total Federal Funding Authorized	\$10,000,000,000	
Total CA SSBCI Allocation	\$1,181,997,613	
Subtotal CA Prorated SSBCI Allocation	\$894,973,879	
Subtotal CA SSBCI SEDI Allocation	\$187,189,392	
Subtotal CA SSBCI SEDI Performance Allocation	\$99,834,342	
Funding is Distributed in Three Tranches. States Must Encumber 80% of their Funds to Access Next Tranche of Funding	Funding in Tranche	80% Target
Tranche 1	\$357,113,879	\$285,691,104
Tranche 2	\$407,031,050	\$661,315,944
Tranche 3	\$417,852,683	
*This is based on California’s allocation as of January 2022.		
Source: Document submitted to the Legislature by the IBank and CPCFA, January 7, 2022		

California’s application proposes to fund three existing small business capital programs and create at least one additional program. *Chart 2* provides details on California’s proposed allocation plan.

Chart 2 - California’s Proposed SSBCI Allocation Plan*	
Existing Programs Funded	Funding Allocated
Small Business Loan Guarantee (IBank)	\$390,998,806
California Capital Access Program (CPCFA)	\$118,199,762
California Capital Access – Collateral Support Program (CPCFA)	\$472,799,045
New Program(s) Funded	Funding Allocated
Venture Capital (IBank)	\$200,000,000
Loan Participation (CPCFA) – under consideration	

Total CA SSBCI Allocation	\$1,181,997,613
*This is based on California’s allocation as of January 2022.	
Source: Document submitted to the Legislature by the IBank and CPCFA, January 7, 2022	

Another key aspect of SSBCI are the leverage ratios. At a minimum, \$1 of public expenditure must result in \$1 of new private investments. In the aggregate, the state’s SSBCI programs are required to target an overall leverage ratio of at least \$10 of new private investment for each \$1 of public funds. These leverage requirements, coupled with a drive to utilize SSBCI funds quickly in order to access the next tranche of funds, create tension between undertaking strategic actions to reach small business borrowers in underserved communities and/or SEDI-eligible. The Legislature, as the policy-making body, should send clear signals about how to approach these multifaceted goals.

- 8) **Potential Reduction in SSBCI Funds:** California’s application is based on information provided by the US Treasury as of January 2022. Recent conversations at the federal level, including those involving the US Congress, propose reallocating some portion of SSBCI funding to pay for other COVID-19 expenses. Any change in SSBCI’s overall program funds will likely impact California’s allocation and possibly the mix of programs.
- 9) **The Small Business Finance Center:** The Small Business Finance Center was established in 2013 following the implementation of the Governor’s Reorganization Plan GRP2, which transferred the IBank and the Small Business Loan Guarantee Program from the soon to be defunct Business, Transportation, and Housing Agency to GO-Biz.

That same year, AB 1247 modified the GRP2 proposal for the placement of the Small Business Loan Program and established the Small Business Finance Center within the IBank [*AB 1247 (Medina and Bocanegra), Chapter 537, Statutes of 2013*]. It was the authors’ intent that the center becomes a multipurpose small business financing entity. To accomplish this objective, the statutory framework of the Small Business Finance Center was drafted to reflect existing programs, as well as the potential need for new financial products. As an example, the Small Business Loan Guarantee Program was specifically codified within the administrative control of the Small Business Center and general statutory authority was also provided for the IBank board to approve and modify a range of financial products, including loans and other debt instruments, as well as loan guarantees and other credit enhancements.

According to information on the IBank website (2/24/2022):

- More than 20,000 loan guarantees have been issued under this program since the early 2000s.
- IBank loan guarantees have helped to create or retain 412,000 jobs.
- During 2019-20, the Small Business Finance Center guaranteed 470 loans, resulting in \$165 million in loan guarantees that supported \$240 million in small business loans.

The IBank and the California Small Business Finance Center have very broad statutory authority to meet the evolving needs of small businesses. In addition to the general loan guarantee program, the Governor has the authority to activate a disaster-specific loan guarantee program. During the early months of the COVID-19 pandemic, the Disaster Loan Guarantee Program was activated for microloans, as well as new financing initiative launched, the California Rebuilding Fund.

10) **California Capital Access Program for Small Businesses:** The CalCAP for Small Business program was established under the administrative control of the CPCFA through legislation enacted in 1994 for the purpose of incentivizing financial institutions to provide small businesses with the capital to maintain and grow their businesses.

The program uses a portfolio-based credit enhancement model, whereby a loss reserve account is established to offset losses incurred in connection with small business loans enrolled in the program. Funding in the loss reserve account consists of moneys paid by the participating borrower and financial institution, with CPCFA matching these contributions.

Unlike a loan guarantee which ensures payment on a certain percentage of the defaulted loan [*80% to 90% in the guarantee program*], under the loss reserve fund model, the amount of the default payment is based on the amount of funds available in the reserve account. This means a lender could potentially recover 100% of the value of the defaulted loan to the extent that there are sufficient moneys are in the account. The model encourages lenders to maintain good underwriting practices because utilization of the loss reserve too often can quickly draw-down the reserve, leaving little for other potential defaults of enrolled loans within the portfolio.

CalCAP loans can be used for working capital and to finance the acquisition of land, construction or renovation of buildings, purchase of equipment, and other capital projects. There are some limitations on real estate loans and loan refinancing. The maximum loan amount is \$2.5 million. Lenders set the terms and conditions of the loans and decide which loans to enroll into CalCAP. Loan fees, which are used to capitalize the loss reserve account, are set by the lender and are in the range of 2% to 3.5% of the total loan amount. Loans can be short- or long-term, have fixed or variable rates, be secured or unsecured, and bear any type of amortization schedule.

CalCAP was initially funded through excess fees from the issuance of CPCFA pollution control tax-exempt bonds. The Legislature appropriated \$6 million in 2010 to expand the program, and in 2011 CalCAP received approximately one-half of the state's \$168 million SSBCI allocation based on a joint application to the US Treasury. Later, California amended its SSBCI application to re-direct \$65 million to a collateral support program.

CPCFA contracts with several state agencies, including the California Air Resources Board and the California Energy Commission, to provide lenders with loan loss reserve accounts to finance new, cleaner-burning, heavy-duty, diesel trucks and buses and the acquisition of electric vehicle charging station equipment.

According to the 2020 Annual Report, through the end of December 2020, the total number of loans enrolled in each CalCAP program is as follows:

- 23,209 - CalCAP for Small Business since 1994 (*proposed to receive SSBCI funds*)
- 29,883 - CalCAP/CARB since 2009
- 329 - CalCAP Collateral Support Program since 2013 (*proposed to receive SSBCI funds*)
- 3 - CalCAP Electric Vehicle Charging Station Financing Program since 2015
- 3 - CalCAP Seismic Safety Program since 2016
- 0 - CalCAP American with Disabilities Act Program.

11) **Proposed Amendments:** Below is a list of amendments the committee members may wish to review when considering the bill.

- a) Add legislative intent language relative to SSBCI.
- b) Rearrange and clarify the CalCAP provisions between lender commitments to participate in the program and conditions for enrolling a loan.
- c) Conform the fair lending standards between CalCAP and Small Business Loan Guarantee Program.

12) **Related Legislation Current Session:** Below is a list of bills from this session that are related to the state's implementation of the SSBCI program.

- a) **AB 2314 (Petrie-Norris) Transparent and Ethical Financial Practices:** This bill sets fair and ethical lending standards for loans issued guarantees under the California Small Business Loan Guarantee Program and financial institutions that participate in the California Capital Access Program. These changes are especially timely as the state anticipates receiving nearly \$1.2 billion in federal State Small Business Credit Initiative funds. Status: Pending in the Assembly Committee on Jobs, Economic Development, and the Economy.
- b) **AB 2376 (Petrie-Norris) One-Stop Capital Shop:** This bill establishes an online platform, the One-Stop Capital Shop, in preparation for the state's receipt of nearly \$1.2 billion in federal State Small Business Credit Initiative funds. The One-stop Capital Shop will assist small businesses in accessing safe funding opportunities and to reduce barriers in access to affordable capital. Among other objectives, the One-Stop Capital Shop platform is intended to serve as a loan marketplace that allows small businesses to compare and access public and private financing programs. Status: Pending in the Assembly Committee on Jobs, Economic Development, and the Economy.
- c) **AB 2400 (Cervantes) California Capital Access Program:** This bill modifies California Capital Access Program in preparation for the state's receipt of nearly \$1.2 billion in federal State Small Business Credit Initiative funds. Proposed changes reflect issues that arose during the first round of SSBCI funding. Status: Pending in the Assembly Committee on Jobs, Economic Development, and the Economy.

13) **Related Legislation from Prior Sessions:** Below is a list of bills from prior sessions.

- a) **AB 29 (John A. Pérez, Feuer, and V. Manuel Pérez) Office of Business and Economic Development:** This bill establishes GO-Biz to include a newly codified California Business Investment Services Program and the existing Office of the Small Business Advocate. Status: Signed by the Governor, Chapter 475, Statutes of 2011.
- b) **AB 796 (Blumenfield) Matching Funds:** This bill, as it related to the CPCFA, would have increased the maximum contribution by the financial institution to \$200,000, if the matching contribution made by CPCFA were funded exclusively from funds made available pursuant to the federal Small Business Jobs Act of 2010. The bill would also have limited the amount of matching funds used for deposits exceeding \$100,000 to not more than 50% of the available funds. Status: Vetoed by the Governor, 2012, for provisions unrelated to CPCFA.
- c) **AB 901 (V. Manuel Pérez) Expand Financial Partners and Reporting Requirements:** This bill expanded the CalCAP definition of financial institution and increased reporting requirements. CalCAP is one of the programs which received millions of dollars in federal and state funding for small businesses through the federal Small Business Jobs Act of 2010. Status: Signed by the Governor, Chapter 483, Statutes of 2011.

- d) **AB 964 (Calderon, Gonzalez Fletcher, Gomez, and Cervantes) California Affordable Clean Vehicle Program:** This bill would have changed the name of an article within the Health and Safety Code from “Capital Access Program for Small Business” to “Capital Access Program.” Consistent with this change, the bill would have established the California Affordable Clean Vehicle Program within the Capitol Loan Access Program to assist low-income individuals in purchasing or leasing zero-emission vehicles or plug-in hybrid electric vehicles for personal or commercial use by providing affordable financing mechanisms. Status: Died in the Senate Committee on Appropriations, 2017.
- e) **AB 981 (Hueso) Expand Financial Partners:** This bill expands the CalCAP definition of a financial institution, authorizes the withdrawal of a lower portion of the interest or other income from a loss reserve account to cover program costs, and requires additional financial assistance to qualified businesses in severely affected communities, such as areas with high unemployment. CalCAP is one of the programs which received millions of dollars in federal and state funding for small businesses through the federal Small Business Jobs Act of 2010. Status: Signed by the Governor, Chapter 484, Statutes of 2011.
- f) **AB 1247 (Medina and Bocanegra) Small Business Finance Center:** This bill establishes the California Small Business Finance Center at the IBank within the Governor’s Office of Business and Economic Development and transfers the authority to administer the small business loan guarantee program and other related programs to the California Small Business Finance Center. Status: Signed by the Governor, Chapter 537, Statutes of 2013.
- g) **AB 1547 (Quirk-Silva) Community Development Financing Reforms:** This bill modifies definitions, updates eligible activities to reflect market conditions, and streamlines processes of programs administered through the California Capital Access ADA Program, California Capital Access Program Seismic Safety Program, California Industrial Development Financing Advisory Commission, California Alternative Energy and Advanced Transportation Financing Authority, Sales & Use Tax Exclusion Program, and PACE Loss Reserve Program. Status: Pending in the Senate Committee on Business, Professions, and Economic Development.
- h) **AB 1553 (Cervantes) Direct Payments to Borrowers:** This bill authorizes the use of moneys in the California Americans with Disabilities Act Small Business Capital Access Loan Program (ADA program) fund for payments to participating financial institutions or borrowers to provide incentives to participate in the ADA program. The bill also allows small business assistance funds to include contributions and nonreimbursable payments made directly to borrowers or participating programs. Status: Signed by the Governor, Chapter 644, Statutes of 2017.
- i) **AB 1632 (Blumenfield) Small Business Capital Infusion:** This bill provides the necessary statutory changes in the area of job creation and small business development in order to implement the 2010 Budget Act. The bill transfers \$32.4 million from the General Fund to support four small business and jobs programs that exist in current law. The funding appropriated in this bill went to the Small Business Loan Guarantee Program (\$20 million); California Capital Access Fund (\$6 million); Small Business Development Centers (\$6 million); and the Federal Technology Centers (\$350,000). Status: Signed by the Governor, Chapter 731, Statutes of 2010.
- j) **SB 225 (Simitian) Loss Reserve Accounts for Truck Leases:** This bill authorizes the establishment of loss reserve accounts for the purposes of terminal rental adjustment clause leasing, if funds are available for contribution into the loss reserve account from any source other than the authority. Status: Signed by the Governor, Chapter 492, Statutes of 2011.

- k) ***SB 551 (Hueso) Transfer of California Capital Access Program***: This bill would have transferred certain funding and loan portfolios from the California Pollution Control Financing Authority to the Small Business Finance Center administered by the California Infrastructure and Economic Development Bank. Status: Held in the Assembly Committee on Appropriations, 2018.
- l) ***SB 832 (Senate Committee on Environmental Quality) Code Maintenance***: This bill revises the Revenue and Tax Code definitions of “project” and “pollution control facility” to conform with those used by the California Pollution Control Financing Authority Act under its sales and use tax exclusion program and includes public agencies within the definition of a “participating party” that is eligible for financial assistance in connection with the projects designed to control or eliminate environmental pollution. Status: Signed by the Governor, Chapter 643, Statutes of 2009.
- m) ***SB 1235 (Glazer) Commercial Financing Disclosures***: This bill creates a new division within the Financial Code, titled “Commercial Financing Disclosures” and requires providers of commercial financing, as defined, to provide disclosures about the cost of that financing to the recipients of the financing, as specified. Status: Signed by the Governor, Chapter 1011, Statutes of 2018.
- n) ***SB 1311 (Simitian) Changes in Deposits and Withdrawals***: This bill reduces the CalCAP monetary contribution of the CPCFA to an amount equal to the amount of fees paid by a participating financial institution. The bill also authorizes the withdrawal of interest or other income from the loss reserve accounts for the purpose of offsetting administrative costs and contributions. Status: Signed by the Governor, Chapter 401, Statutes of 2008.
- 14) **Double Referral**: The Assembly Committee on Rules referred this measure to two policy committee for review. The Assembly Committee on Banking passed this measure on April 18, 2022 on a 12 to 0 vote.

REGISTERED SUPPORT / OPPOSITION:

Support

Accion Opportunity Fund
 California Asian Pacific Chamber of Commerce (CAPCC)
 CAMEO - California Association for Micro Enterprise Opportunity
 Consumer Federation of California
 Pacific Community Ventures
 Small Business Majority

Opposition

None on File

Analysis Prepared by: Toni Symonds / J., E.D., & E. / (916) 319-2090