

AMENDED IN ASSEMBLY MARCH 24, 2022

CALIFORNIA LEGISLATURE—2021–22 REGULAR SESSION

ASSEMBLY BILL

No. 2314

Introduced by Assembly Member Petrie-Norris

February 16, 2022

An act to amend Section 63089.70 of the Government Code, and to amend Section 44559.1 of the Health and Safety Code, relating to business.

LEGISLATIVE COUNSEL'S DIGEST

AB 2314, as amended, Petrie-Norris. State-guaranteed commercial financial products for small ~~businesses~~. *businesses: Small Business Expansion Fund: Capital Access Loan Program.*

~~Existing~~

(1) ~~Existing~~ law establishes the California Infrastructure and Economic Development Bank within the Governor's Office of Business and Economic Development. Under the Small Business Financial Assistance Act of 2013, specific programs relating to small business are administered either directly by the bank or under contract with small business financial development corporations. Existing law establishes within the bank the California Small Business Finance Center and authorizes the center to administer programs to assist businesses seeking new capital resources, including, but not limited to, the Small Business Loan Guarantee ~~Program~~. *Program, which provides guarantees to loans offered by financial institutions and financial companies to small businesses, as provided, from the Small Business Expansion Fund.*

This bill would require a loan guarantee provided under the Small Business Loan Guarantee Program that is funded by the federal State Small Business Credit Initiative Act of 2010, as specified, to meet

specified conditions, including, among other things, that a borrower not be required to sign a confession of judgment, that the guaranteed loan not be refinanced or renewed, nor be used to refinance or renew another loan, if the new loan to refinance or renew includes unpaid or unaccrued interest or fees to pay off the balance of the previous loan, and that the final payoff amount of the guaranteed loan not vary based upon the source of the funds used to make the final payoff.

~~Existing~~

(2) Existing law establishes the Capital Access Loan Program for Small Businesses, which is administered by the California Pollution Control Financing Authority, to assist qualifying small businesses in the state access capital. Existing law authorizes the authority to enter into contracts with participating financial institutions and authorizes a participating financial institution that experiences a default on a qualified loan enrolled in the Capital Access Loan Program to obtain reimbursement from the authority, as specified.

~~This bill would state the intent of the Legislature to enact legislation relating to state-guaranteed commercial financial products for small businesses.~~

Existing law defines terms for the purposes of the Capital Access Loan Program, including, among other terms, a “participating financial institution.”

This bill would revise the definition of “participating financial institution” to include participating financial institutions that engage in unfair, unethical, or nontransparent practices with respect to small businesses, including, among other things, requiring a borrower to sign a confession of judgment, refinancing or renewing a qualified loan, or refinancing or renewing another loan, if the new loan to refinance or renew includes unpaid or unaccrued interest or fees to pay off the balance of the previous loan, and varying the final payoff amount of a qualified loan based upon the source of the funds used to make the final payoff, as specified.

Vote: majority. Appropriation: no. Fiscal committee: ~~no~~-yes.
State-mandated local program: no.

The people of the State of California do enact as follows:

1 SECTION 1. The Legislature finds and declares all of the
2 following:

1 (a) *That the integrity of small business lending programs are*
2 *of paramount importance to California’s small business owners.*
3 *Fostering a healthy small business lending marketplace will*
4 *encourage the equitable recovery of established businesses and*
5 *foster new small business creation.*

6 (b) *There are 4.1 million small businesses in California. Small*
7 *business owners employ roughly one-half of the private sector*
8 *workforce and, since the Great Recession, have been the largest*
9 *drivers of new job growth in our country. Despite these facts, small*
10 *business owners struggle to access capital from traditional lending*
11 *institutions like banks and credit unions. The index of commercial*
12 *and industrial lending dropped below zero percent late in 2020*
13 *and continued to be below –10% in September 2021. After the*
14 *Great Recession, bank lending under \$250,000 declined*
15 *significantly.*

16 (c) *New small business startups are rapidly growing. The United*
17 *States Census Bureau’s data on new firm formations shows that*
18 *new business applications grew by almost 2 million between 2019*
19 *and 2021, a higher rate than ever before. This is especially true*
20 *for non-White business owners. After experiencing the largest*
21 *number of small business closures in April 2020, the number of*
22 *Black and Latino-owned firms were significantly higher in*
23 *September 2021 than in February 2020.*

24 (d) *As a result, many small business owners turn to online*
25 *lending as they struggle to find the capital they need in order to*
26 *grow and expand. Financial products that allow small businesses*
27 *to access hard-to-obtain capital often lack transparency, and recent*
28 *research by the Federal Reserve concluded Black and Hispanic*
29 *entrepreneurs are twice as likely to be affected by “potentially*
30 *higher-cost and less-transparent credit products.” A study by*
31 *Accion Opportunity Fund demonstrates that California small*
32 *business owners take out online loans at an average Annual*
33 *Percentage Rate of 94 percent, and many terms or conditions are*
34 *not made clear to business owners, like products that come with*
35 *hidden fees and obscure rates. Most small business owners cannot*
36 *afford to make these mistakes.*

37 (e) *Therefore, lenders participating in state lending programs*
38 *funded by taxpayer dollars should use fully transparent and fair*
39 *lending practices to ensure that small business borrowers can*

1 *access the capital they need in order to grow and expand their*
2 *businesses.*

3 *SEC. 2. Section 63089.70 of the Government Code is amended*
4 *to read:*

5 63089.70. (a) The Small Business Expansion Fund, which is
6 hereby continued in existence, shall, among other things, provide
7 guarantees to loans offered by financial institutions and financial
8 companies to small businesses.

9 (b) The Legislature finds and declares that the Small Business
10 Loan Guarantee Program has enabled participating small businesses
11 that do not qualify for conventional business loans or Small
12 Business Administration loans to secure funds to expand their
13 businesses. These small businesses would not have been able to
14 expand their businesses in the absence of the program. The program
15 has also provided valuable technical assistance to small businesses
16 to ensure growth and stability. The study commissioned by former
17 Section 14069.6 of the Corporations Code, as added by Chapter
18 919 of the Statutes of 1997, documented the return on investment
19 of the program and the need for its services. The value of the
20 program has also been recognized by the Governor through
21 proposals contained in the May Revision to the Budget Act of
22 2000 for the 2000–01 fiscal year.

23 (c) A corporation shall not issue a guarantee under this section
24 unless it determines that the following conditions are satisfied:

25 (1) There is a low probability that the loan being guaranteed
26 would be granted by a financial company or financial institution
27 under reasonable terms and conditions and the borrower has
28 demonstrated a reasonable prospect of repayment.

29 (2) The loan proceeds will be used exclusively in this state.

30 (3) The loan qualifies as a small business loan or an employment
31 incentive loan.

32 (4) The borrower has a minimum equity interest in the business
33 as determined by the directives and requirements.

34 (5) As a result of the loan being guaranteed, the jobs generated
35 or retained demonstrate reasonable conformance to any directives
36 and requirements specifying employment criteria.

37 (d) *A loan guarantee funded by the federal State Small Business*
38 *Credit Initiative Act of 2010 (Public Law 111-240), as modified*
39 *by the American Rescue Plan Act of 2021 (Public Law 117-2),*
40 *shall be issued only if it meets all of the following conditions:*

1 (1) *The guaranteed loan shall not require the borrower to sign*
2 *a confession of judgment, as defined in subdivision (a) of Section*
3 *1132 of the Code of Civil Procedure.*

4 (2) *The guaranteed loan shall not be refinanced or renewed,*
5 *nor shall it be used to refinance or renew another loan, if the new*
6 *loan to refinance or renew includes unpaid or unaccrued interest*
7 *or fees, as defined in Section 22500 of the Financial Code, to pay*
8 *off the balance of the previous loan.*

9 (3) *The final payoff amount of the guaranteed loan shall not*
10 *vary based upon the source of the funds used to make the final*
11 *payoff.*

12 (4) *The guaranteed loan shall consider repayment funds from*
13 *a third party as equivalent to funds from the borrower.*

14 (5) *The guaranteed loan repayment information shall be sent*
15 *to a commercial credit reporting agency, as defined in subdivision*
16 *(b) of Section 1785.42 of the Civil Code, and credit data shall be*
17 *consulted when underwriting the guaranteed loan.*

18 (6) *The guaranteed loan's borrower and any guarantors shall*
19 *be informed if the financial institution or corporation intends to*
20 *report guaranteed loan repayment performance to a commercial*
21 *credit reporting agency if default occurs.*

22 (7) *The guaranteed loan shall follow a schedule of conditions*
23 *concerning hidden payment charges, as follows:*

24 (A) *The guaranteed loan shall disclose financing charges other*
25 *that interest accrued since the last payment as "prepayment*
26 *charges."*

27 (B) *The guaranteed loan shall disclose any additional charges*
28 *or fees added in the case of prepayment as "prepayment penalties."*

29 (C) *The guaranteed loan shall disclose potential prepayment*
30 *charges and penalties in any loan offer summary.*

31 (D) *The guaranteed loan shall disclose actual prepayment*
32 *charges and penalties at the time of prepayment.*

33 (8) *The guaranteed loan shall be given to a borrower that can*
34 *afford the loan or that has a credible path to profitability, meaning*
35 *that the firm has a debt-service coverage ratio of greater than*
36 *1.00.*

37 (9) *The guaranteed loan shall be given to a borrower that can*
38 *afford the loan or that has a credible path to profitability if the*
39 *financial institution received repayment directly from the*
40 *borrower's gross receipts, such as through credit cards, payments*

1 *process, or daily payments, that prevent the borrower from paying*
2 *for operating expenses first.*

3 *SEC. 3. Section 44559.1 of the Health and Safety Code is*
4 *amended to read:*

5 44559.1. As used in this article, unless the context requires
6 otherwise, all of the following terms have the following meanings:

7 (a) “Authority” means the California Pollution Control
8 Financing Authority.

9 (b) “California Capital Access Fund” means a fund created
10 within the authority to be used for purposes of the program.

11 (c) “Executive director” means the Executive Director of the
12 California Pollution Control Financing Authority.

13 (d) (1) “Financial institution” means a federal- or state-chartered
14 bank, savings association, credit union, not-for-profit community
15 development financial institution certified under Part 1805
16 (commencing with Section 1805.100) of Chapter XVIII of Title
17 12 of the Code of Federal Regulations, or a consortium of these
18 entities. A consortium of those entities may include a nonfinancial
19 corporation, if the percentage of capitalization by all nonfinancial
20 corporations in the consortium does not exceed 49 percent.

21 (2) (A) “Financial institution” also includes a lending institution
22 that has executed a participation agreement with the Small Business
23 Administration under the guaranteed loan program pursuant to
24 Part 120 (commencing with Section 120.1) of Chapter I of Title
25 13 of the Code of Federal Regulations and meets the requirements
26 of Section 120.410 of Chapter I of Title 13 of the Code of Federal
27 Regulations, a small business investment company licensed
28 pursuant to Part 107 (commencing with Section 107.20) of Chapter
29 I of Title 13 of the Code of Federal Regulations, and a small
30 business financial development corporation, as defined in Chapter
31 1 (commencing with Section 14000) of Part 5 of Division 3 of
32 Title 1 of the Corporations Code, or microbusiness lender, as
33 defined in Section 12100 of the Government Code, that meets
34 standards that shall be established by the authority. For loans where
35 all or part of the fees and matching contributions are paid by an
36 entity participating in the program pursuant to subdivision (e) of
37 Section 44559.2, “financial institution” also includes financial
38 lenders, as defined in Section 22009 of the Financial Code, making
39 commercial loans, as defined in Section 22502 of the Financial
40 Code.

1 (B) A financial institution described in this paragraph shall be
2 domiciled or have its principal office in the State of California.

3 (3) “Financial institution” also includes an insured depository
4 institution, insured credit union, or community development
5 financial institution, as these terms are defined in Section 4702 of
6 Title 12 of the United States Code.

7 (e) “Loss reserve account” means an account in the State
8 Treasury or any financial institution that is established and
9 maintained by the authority for the benefit of a financial institution
10 participating in the Capital Access Loan Program established
11 pursuant to this article for the purposes of the following:

12 (1) Depositing all required fees paid by the participating
13 financial institution and the qualified business.

14 (2) Depositing contributions made by the state and, if applicable,
15 the federal government or other sources.

16 (3) Covering losses on enrolled qualified loans sustained by the
17 participating financial institution by disbursing funds accumulated
18 in the loss reserve account.

19 (f) “Participating financial institution” means a financial
20 institution that has been approved by the authority to enroll
21 qualified loans in the program and has agreed to all terms and
22 conditions set forth in this article and as may be required by any
23 applicable federal law providing matching funding. “*Participating*
24 *financial institution*” includes, but is not limited to, participating
25 *financial institutions that engage in unfair, unethical, or*
26 *nontransparent practices with small businesses, such as the*
27 *following:*

28 (1) *The participating financial institution shall not require the*
29 *borrower of the qualified loan to sign a confession of judgment,*
30 *as defined in subdivision (a) of Section 1132 of the Code of Civil*
31 *Procedure.*

32 (2) *The participating financial institution shall not refinance*
33 *or renew a qualified loan, nor shall it use a qualified loan to*
34 *refinance or renew another loan, if the new loan to refinance or*
35 *renew includes unpaid or unaccrued interest or fees, as defined*
36 *in Section 22500 of the Financial Code, to pay off the balance of*
37 *the previous loan.*

38 (3) *The participating financial institution may not provide*
39 *information required for prepayment beyond two days from the*

1 *date upon which the borrower requests to prepay or refinance a*
2 *loan.*

3 *(4) The participating financial institution shall not vary the final*
4 *payoff amount of the guaranteed loan based upon the source of*
5 *the funds used to make the final payoff.*

6 *(5) The participating financial institution shall consider*
7 *repayment funds from a third party as equivalent to funds from*
8 *the borrower.*

9 *(6) The participating financial institution shall send repayment*
10 *information to a commercial credit reporting agency, as defined*
11 *in subdivision (b) of Section 1785.42 of the Civil Code, and credit*
12 *data shall be consulted when underwriting the guaranteed loan.*

13 *(7) The participating financial institution shall inform the*
14 *borrower and any guarantors shall if it intends to report*
15 *guaranteed loan repayment performance to a commercial credit*
16 *reporting agency if default occurs.*

17 *(8) The participating financial institution shall ensure that the*
18 *borrower can afford the loan or that it has a credible path to*
19 *profitability, meaning that the borrower has a debt service*
20 *coverage ratio greater than 1.00.*

21 *(9) The participating financial institution shall ensure that the*
22 *borrower can afford the loan or that it has a credible path to*
23 *profitability if the financial institution receives repayment directly*
24 *from the qualified loan's borrower's gross receipts, such as*
25 *through credit card, payments processing, or daily payments, that*
26 *prevents that qualified loan's borrower from paying for operating*
27 *expenses first.*

28 *(10) The participating financial institution shall follow a*
29 *schedule of conditions concerning hidden payment charges, as*
30 *follows:*

31 *(A) The qualified loan shall disclose financing charges other*
32 *than interest accrued since the last payment as "prepayment*
33 *charges."*

34 *(B) The qualified loan shall disclose any additional charges or*
35 *fees added in the case of prepayment as "prepayment penalties."*

36 *(C) The qualified loan shall disclose potential prepayment*
37 *charges and penalties in any loan offer summary.*

38 *(D) The qualified loan shall disclose actual prepayment charges*
39 *and penalties at the time of prepayment.*

1 (g) “Passive real estate ownership” means ownership of real
2 estate for the purpose of deriving income from speculation, trade,
3 or rental, but does not include any of the following:

4 (1) The ownership of that portion of real estate being used or
5 intended to be used for the operation of the business of the owner
6 of the real estate.

7 (2) The ownership of real estate for the purpose of construction
8 or renovation, until the completion of the construction or renovation
9 phase.

10 (h) “Program” means the Capital Access Loan Program created
11 pursuant to this article.

12 (i) “Qualified business” means a small business concern that
13 meets both of the following criteria, regardless of whether the
14 small business concern has operations that affect the environment:

15 (1) It is a corporation, partnership, cooperative, or other entity,
16 whether that entity is a nonprofit entity or an entity established for
17 profit, that is authorized to conduct business in the state.

18 (2) It has its primary business location within the boundaries of
19 the state.

20 (j) (1) “Qualified loan” means a loan or a portion of a loan
21 made by a participating financial institution to a qualified business
22 for any business activity that has its primary economic effect in
23 California. A qualified loan may be made in the form of a line of
24 credit, in which case the participating financial institution shall
25 specify the amount of the line of credit to be covered under the
26 program, which may be equal to the maximum commitment under
27 the line of credit or an amount that is less than that maximum
28 commitment. A qualified loan made under the program may be
29 made with the interest rates, fees, and other terms and conditions
30 agreed upon by the participating financial institution and the
31 borrower.

32 (2) “Qualified loan” does not include any of the following:

33 (A) A loan for the construction or purchase of residential
34 housing.

35 (B) A loan to finance passive real estate ownership.

36 (C) A loan for the refinancing of an existing loan when and to
37 the extent that the outstanding balance is not increased.

38 (D) A loan, the proceeds of which will be used in any manner
39 that could cause the interest on any bonds previously issued by
40 the authority to become subject to federal income tax.

1 (k) “Severely affected community” means any area classified
2 as an enterprise zone pursuant to the Enterprise Zone Act (Chapter
3 12.8 (commencing with Section 7070) of Division 7 of Title 1 of
4 the Government Code), any area, as designated by the executive
5 director, contiguous to the boundaries of a military base designated
6 for closure pursuant to Section 2687 of Title 10 of the United States
7 Code, as amended, and any other comparable economically
8 distressed geographic area so designated by the executive director
9 from time to time.

10 (l) “Small Business Assistance Fund” means a fund created
11 within the authority pursuant to Section 44548.

12 (m) “Small business concern” has the same meaning as in
13 Section 632 of Title 15 of the United States Code, or as otherwise
14 provided in regulations of the authority.

15 ~~SECTION 1. It is the intent of the Legislature to enact~~
16 ~~legislation relating to state-guaranteed commercial financial~~
17 ~~products for small businesses.~~