Sustainability and Integrity:

A Proposal for Strengthening the CalCAP Small Business Programs

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Context & Assumptions

The purpose of the CalCAP loan Loss Reserve program is to incentivize lenders to make loans they would not make without the reserve. Success should be defined by the ratio of business loans and/or jobs created per state dollar used.

Self-sufficiency of a program is a means to achieving program impacts, not an end in itself and it is more relevant for the most successful programs.

The essential power of a loan loss reserve is the risk pooling function. The state contribution on any one loan is very small, loans must therefore be pooled in order to have sufficient coverage for potential losses. This is fundamentally different from individual loan guarantees such as the Collateral Support program.

Match rates are the most effective way to incentivize lenders to serve different populations.

Disincentives for higher defaults are already build into the individual lenders’ loan loss reserve pool, as high claims will yield lower coverage for future loans.

Proposal Overview

20% Threshold Recapture: Each lender can build up and maintain reserves to cover up to 20% losses on enrolled loans. Amounts above that 20% threshold can be recaptured by CPCFA and recycled for new Small Business or ARB loans.

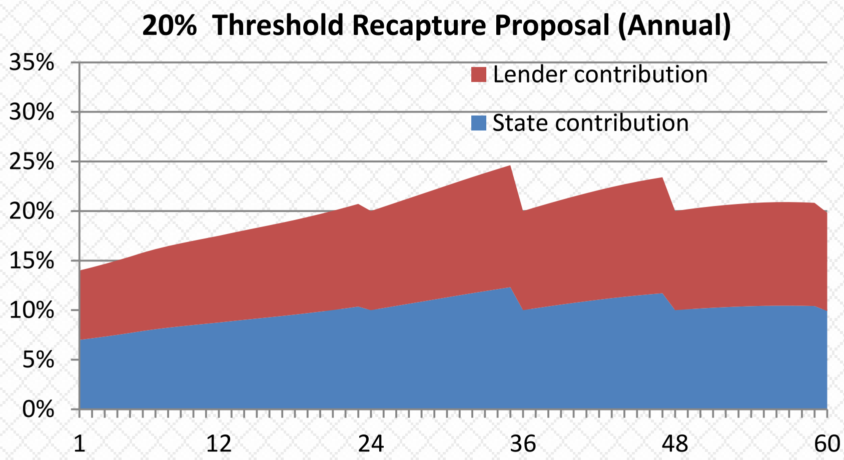
Ongoing Loan Enrollment: If the state runs out of matching funds, lenders can continue to enroll new loans against their loan loss reserve account and pay an administrative fee directly to CPCFA.

Make Funds Go Further: Reduce the minimum amount both parties can contribute on each covered loan from 2% to 1% of the loan amount, to ensure public funds go further while still providing lenders needed coverage against risk.

Clarify Lender Exit: Create standard procedures for returning contributions if a lender exits the program to build lender confidence, ensuring continued lender participation.

20% Threshold Recapture

Each lender can build up and maintain reserves to cover up to 20% losses on enrolled loans. Amounts above that 20% threshold can be recaptured by CPCFA and recycled for new Small Business or ARB loans.



Benefits:

- Frees up funds to enroll new loans
- Allows lenders to plan for specified loss rate
- Gives new lenders time to build up a healthy reserve before recapture
- Administratively simple

Ongoing Loan Enrollment

If the state runs out of matching funds, lenders can continue to enroll new loans against their loan loss reserve account and pay an administrative fee directly to CPCFA for loan enrollment and claims.

Benefits:

- Increases lender confidence that regardless of future funding, LLR funds can be put to maximum use.
- Provides funding for CPCFA for ongoing program administration.
- Incentivizes lenders to be prudent with LLR funds so they are available for future loans.

Make Funds Go Further

Reduce the minimum amount both lenders and the state can contribute on each covered loan from 2% to 1% of the loan amount.

Benefits:

- Ensures public funds go further
- Provides greater flexibility for lenders to maximize existing LLR funds by enrolling new loans with minimum contributions.
- Administratively simple

2% → 1%

Clarify Lender Exit

Create standard procedures for returning contributions if a lender exits the program, including an option for lenders to give up any right to file claims. The lenders' share would be proportional to their relative contribution in the account.

Benefits:

- Increases lender and investor confidence in LLR program
- Recycle funds more quickly from lenders who are no longer actively participating

Conclusions

Due to limited resources, recapture is necessary and can be structured in a way that will not undermine the program's success if:

- Recycled funds are used for small business loan purposes
- Risk pooling function continues with 20% threshold recapture
- Lenders can continue to enroll new loans against their balance

Lender confidence and participation is critical:

- Provisions for lender exit should be clarified
- Regulatory changes should be reinforced through legislation to provide greater long term certainty