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MEMORANDUM

To: Members, Finance Subcommittee
Governing Board
California Institute for Regenerative Medicine

From: James C. Harrison

Date: November 29, 2010

Re: Loan Program (Our File No.: 2297-0)

INTRODUCTION

At its meeting on December 3, 2010, the Finance Subcommittee will be asked to consider two approaches to making the loan program more attractive to industry. These approaches are not mutually exclusive. The Finance Subcommittee could recommend that the Board adopt one of the proposals or both proposals. If the Board were to adopt both proposals, loan recipients would be required to choose, at the commencement of the loan, which form of risk premium they desire. This memorandum briefly describes the two approaches.

A. Amendment of the Loan Administration Policy Warrant Provisions

1. Current Regulations

Currently, the Loan Administration Policy requires that loan recipients provide CIRM with warrants as a risk premium. For company-backed loans, the loan recipient is required to provide CIRM with warrants equal to the lesser of 20% of loan recipient's shares, fully diluted and:

(1) 10% of the loan amount if loan recipient shows a profit for previous two years;

(2) 25% of the loan amount if the loan recipient has: (a) raised in prior financings since its inception three times the total amount of

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the loan; AND (b) entered into a contractual arrangement (still in effect) with a biotechnology or pharmaceutical company which requires the payment of licensing revenues or milestone payments predicated on the success of a funded project (regardless of whether it is a CIRM Funded Project); or

(3) 50% of the loan amount if the loan recipient has met only one of the two requirements set forth above in (2);

(4) 75% of the loan amount if none of the criteria set forth in (2) are satisfied.

For product-backed loans, the loan recipient is required to provide CIRM with warrants equal to the lesser of 20% of loan recipient's shares, fully diluted and:

(1) 50% of the loan amount if the loan amount is less than 50% of the total funds required to complete the CIRM-Funded Project as defined in the Notice of Loan Award;

(2) 60% of the loan Amount if the loan amount is less than 75% of the total funds required to complete the CIRM-Funded Project as defined in the Notice of Loan Award; or

(3) 100% of the loan amount if the loan amount represents more than 75% of the total funds required to complete the CIRM-Funded Project as defined in the Notice of Loan Award.

Some industry representatives have expressed concern regarding CIRM's warrant coverage requirements. In an effort to address those concerns, the Chair of the Loan Task Force, Duane Roth, has proposed modifying the warrant coverage as set forth below.

2. Proposed Company-Backed Loan Amendment

Warrant coverage for company-backed loans would be modified as follows (deletions are reflected in strike-out text and additions are in bold and italics):

For company-backed loans, the loan recipient is required to provide CIRM with warrants equal to the lesser of 20% of loan recipient's shares, fully diluted and:

(1) 10% of the loan amount if loan recipient shows a profit for previous two years;

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(2) 25% of the loan amount if the loan recipient has: (a) raised in prior financings since its inception three times the total amount of the loan; ~~OR AND~~ (b) entered into a contractual arrangement (still in effect) with a biotechnology or pharmaceutical company which requires the payment of licensing revenues or milestone payments predicated on the success of a funded project (regardless of whether it is a CIRM Funded Project); or

(3) 50% of the loan amount if the loan recipient has *not* met ~~only one of the two~~ *either of the* requirements set forth above in (2); 75% of the loan amount if ~~none of the criteria set forth in (2)~~ are satisfied.

3. Proposed Product-Backed Loan Amendment

Warrant coverage for product-backed loans would be modified as follows (deletions are reflected in strike-out text and additions are in bold and italics):

For product-backed loans, the loan recipient is required to provide CIRM with warrants equal to the lesser of 20% of loan recipient's shares, fully diluted and:

(1) *the amount of CIRM's contribution as a percentage of 50% of the loan amount if the loan amount is less than 50% of the total funds required to complete the CIRM-Funded Project, as defined in the Notice of Loan Award; **this allocation will be determined at the time of each loan disbursement, e.g., if CIRM's funds represent 60% of the project costs for the period covered by the first disbursement, the loan recipient would be required to provide CIRM with warrant coverage equal to 60% of the project costs during the period covered by the first disbursement; if CIRM funds represent 30% of the total project costs during the period covered by the second disbursement, then CIRM would be entitled to warrant coverage equal to 30% of the total project costs for that period.***

~~(2) 60% of the loan amount if the loan amount is less than 75% of the total funds required to complete the CIRM-Funded Project as defined in the Notice of Loan Award; or~~

~~(3) 100% of the loan amount if the loan amount represents more than 75% of the total funds required to complete the CIRM-Funded Project as defined in the Notice of Loan Award.~~

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Because these provisions are included in the Loan Administration Policy, which is currently undergoing review by the Office of Administrative Law, CIRM would have to open a new rule-making to adopt these changes. This process would require approximately four to five months before the revised warrant provisions would become effective. The Loan Administration Policy permits an amendment to be applied retroactively, provided the loan recipient and CIRM agree.

B. Payback Alternative

Bob Klein, the Chair of the Governing Board, has proposed an alternative to warrant coverage. Under Mr. Klein's proposal, a loan recipient could opt for warrant coverage or, in the alternative, could agree to repay CIRM, in addition to principal and interest, a multiple of the loan amount, depending upon the level of success achieved, as a risk premium. This proposal is set forth in attachment A.

Under Proposition 71, the Board has authority to adopt "interim" regulations outside the scope of the Administrative Procedure Act. Because the payback alternative is not currently addressed by an existing regulation, the Board could adopt the payback alternative as an interim regulation. Interim regulations take effect immediately upon adoption by the Board and survive for 270 days, affording time to adopt a final regulation pursuant to the Administrative Procedure Act. In addition, as discussed above, the Loan Administration Policy permits an amendment to be applied retroactively, provided the loan recipient and CIRM agree.

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ATTACHMENT A

