

BROKEN PROMISES: THE SMALL BUSINESS LENDING FUND'S BACKDOOR BANK BAILOUT

HEARING

BEFORE THE

COMMITTEE ON OVERSIGHT
AND GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

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LENDING FUND'S BACKDOOR BANK BAILOUT

Wednesday, April 24, 2013,

HOUSE OF REPRESENTATIVES,
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM,
Washington, D.C.

The committee met, pursuant to notice, at 9:30 a.m. in room 2154, Rayburn House Office Building, the Honorable Darrell Issa [chairman of the committee], presiding.

Present: Representatives Issa, Turner, McHenry, Jordan, Walberg, Lankford, Gosar, Farenthold, Meadows, Cummings, Clay, Connolly, Duckworth, Kelly, Davis, Horsford, .

Staff Present: Alexia Ardolina, Majority Assistant Clerk; Kurt Bardella, Majority Senior Policy Advisor; Molly Boyd, Majority Parliamentarian; Lawrence Brady, Majority Staff Director; John Cuaderes, Majority Deputy Staff Director; Brian Daner, Majority Counsel; Adam P. Fromm, Majority Director of Member Services and Committee Operations; Linda Good, Majority Chief Clerk; Christopher Hixon, Majority Deputy Chief Counsel, Oversight; Michael R. Kiko, Majority Staff Assistant; Mark D. Marin, Majority Director of Oversight; James Robertson, Majority Senior Professional Staff Member; Laura L. Rush, Majority Deputy Chief Clerk; Scott Schmidt, Majority Deputy Director of Digital Strategy; Rebecca Watkins, Majority Deputy Director of Communications; Beverly Britton Fraser, Minority Counsel; Kevin Corbin, Minority Professional Staff Member; Jennifer Hoffman, Minority Press Secretary; Elisa LeNier, Minority Deputy Clerk; Lucinda Lessley, Minority Policy Director; Jason Powell, Minority Senior Counsel; Dave Rapallo, Minority Staff Director; Rory Sheehan, Minority New Media Press Secretary.

Chairman ISSA. The committee will come to order.

Today's hearing, Broken Promises: Small Business Lending Funds Backdoor Bailout, will come to order. But before we begin, I would like to yield to the ranking member to introduce our newest member to the committee.

Mr. CUMMINGS. Mr. Chairman, thank you very much. It is with tremendous pleasure that I introduce the committee to our newest member, Ms. Robin Kelly, from Illinois, Chicago specifically. She has a record of standing up for the rights of citizens and working very hard to make sure that folks live the very best lives that they can.

She is a very brilliant young lady. Her reputation precedes her. We just want you to know, Congresswoman Kelly, that we welcome you, we look forward to working with you. As you know, we have quite a bit of jurisdiction in this committee. So you fit right in, with

the types of things that you have been concerned about are the very things that we address on a daily basis.

So welcome, and I am sure you will find that on both sides of the aisle you will have a welcome reception. We try to work together to get as much done as we possibly can. Welcome.

Thank you, Mr. Chairman.

Chairman ISSA. Thank you, Mr. Cummings. I might note, one of the rules of the committee that I think you will be pleased about is that you are here at the gavel, if you look from Mr. Cummings down, you are fourth to ask questions when we come up. All these empty chairs, they will come after you. So welcome to the timeliness of the committee also.

And you, you are fifth.

[Laughter.]

Chairman ISSA. Good morning. The Oversight Committee's mission statement is that we exist to secure two fundamental principles. First, Americans have a right to know that the money Washington takes from them is well spent. And second, Americans deserve an efficient, effective government that works for them.

Our duty on the Oversight and Government Reform Committee is to protect these rights. Our solemn responsibility is to hold government accountable to taxpayers. Because taxpayers have a right to know what they get from their government.

We will work tirelessly in partnership with citizen watchdogs to deliver the facts to the American people and bring genuine reform to the Federal bureaucracy.

Today I might note that at the White House signing ceremony in 2010, President Obama promised that Small Business Lending Fund would help main street banks lend to main street small businesses. That is a portion of the signing ceremony that I remember, because in fact, it was one of the important promises, and one that I believed we would keep. Because small business and their access to capital is the difference between growth and no growth.

The truth is, large corporations had a short-term problem of capital, and it disappeared almost overnight. Since that time, whether it is the high yield or other forms of access, large companies, particularly public companies, have had access to some of the least expensive money in my lifetime. But today, we will see the Special Inspector General's audit reveals the primary reason why the Fund exists was to give banks a backdoor exit out of TARP. That bothers me. I wish it wasn't so. I wish it wasn't in the report. But, in fact, while banks were helping themselves, small businesses, the engine of our economy, were not getting the assistance they need.

Two point seven billion dollars, or more than two-thirds of all SBLF funds, went to banks that were already in TARP. With the Treasury Department's blessing, these banks used 80 percent of those funds to exit TARP at a lower interest rate, rather than lend it out to small businesses. That means millions of taxpayer dollars were taken away from the American people and allowed to sit in the accounts of banks that received TARP funds.

With the Administration's blessing, and I might note, the Administration is a very broad word, and during this hearing, we will get more refined as to who in the Administration, TARP banks were

able to escape restrictions on governance, executive pay, and luxury expenditures.

What I can't get past is the fact that former Treasury Secretary Geithner made the absurd prediction that these banks would lend out \$10 for every \$1 in funding. The audit sampling found that TARP banks lent out only \$1.13 for every \$1 in SBLF funds. Once again, the American people were told one thing and in fact, for self-interest of the banks that received this, just the opposite occurred.

There are real inconsistencies to what was said and what was done that create real questions of what the Treasury Department should have done and how they are going to explain to us their failure. I asked the Treasury Department to appear before today's hearing. They refused, even though the committee offered them that we would make extraordinary exceptions and accommodations for their participation.

Let me be clear. Their absence does not absolve them of the responsibility to answer questions to the American people they have a right to know.

I will today submit questions to the Treasury Department in the record. And I imagine the gentleman from Maryland, Mr. Cummings, will also have many questions. I insist that we be answered those questions, or we will have another hearing. This committee looks for waste, fraud and abuse. To put this money into people who didn't need it is not only wasteful of funds, but it ultimately denied the American people that GDP growth they so much wanted and needed.

I represent small business. Not just in that I have many in my district, but I came from small business. I know that in fact capital accumulation for growth is the hardest thing for a small business to do. They lean heavily on their community banks. They lean heavily at times on SBA. There is no basis under which that should have happened.

I might note in closing, TARP has been a success when it comes to big banks paying back their loans. They paid them back early, they paid them back with interest. The truth was, most of the banks that received TARP money never really needed it except as a confidence statement. That reality says that this was less excusable, much less excusable because ultimately they were going to pay it back. This simply gave them an ability to do it sooner and for less.

With that, I recognize my partner and colleague in this, Mr. Cummings, for his opening statement.

Mr. CUMMINGS. Thank you very much, Mr. Chairman.

And thank you, Ms. Romero, for testifying before us today. We appreciate your service, and we thank you and everyone in your office for the work that you do. It is outstanding work.

Small businesses are the lifeblood of our Country's economy. When small businesses thrive, America thrives. When small businesses have access to credit, they hire more workers and they replenish their inventories.

This was the rationale behind the passage of the Small Business Jobs Act of 2010. In order to help small banks increase their lending to small businesses, Congress created the Small Business Lending Fund as an investment in America's future. Since the inception

of the program in 2011, it has been a marked success. Lending to small businesses has increased by \$8.9 billion, which translates to more than 38,000 new loans to small businesses.

More than 80 percent of these loans are for less than \$250,000 and they are making a critical difference to a host of very small but very important businesses. My home State of Maryland has benefitted greatly from this program. Participating banks have increased their loans to small businesses by more than \$280 million. I am proud to think of the number of family-owned restaurants, florists and day care centers that are thriving with these loans.

The chairman's home State of California is also benefitting from this program. California's small community banks participating in the program have increased their lending to small businesses by more than \$590 million. The fact is that the entire Country is benefitting from this program, particularly in the southwest, where more than 11,000 small businesses have received loans, and in the chairman's region in the southwest, where 9,500 small businesses have received new loans.

Today we hear about a report issued by the Special Inspector General for TARP that is critical of this program because it allows financial institutions to essentially refinance some of their TARP funds with funds from the Small Business Loan program. We have to keep in mind, however, that this is exactly what Congress authorized. We did this in 2010 when we created the program. We wanted to incentivize banks to make loans to small businesses as across the Country in order to spur growth to help lift our economy out of the recession.

And the bottom line is that the program is working. All of the banks are making their interest payments to the Treasury Department, and not one has missed a payment. In fact, Treasury now estimates that these investments will be repaid fully, along with \$50 million profit to the American taxpayer.

Although I appreciate SIGTARP's work, today's hearing would have been more helpful to the committee members if we could have heard from additional witnesses. I agree with the chairman that that is essential. For example, Treasury officials should be here to offer their response, but they were given only eight days notice and they could not complete their testimony in a short time frame. This is according to them.

For this reason, Mr. Chairman, I ask that a letter sent on March 28th, 2013, from Deputy Assistant Treasury Secretary Don Graves, responding to SIGTARP's report, be entered into the record.

Chairman ISSA. Without objection.

Mr. CUMMINGS. I also think committee members would have benefitted greatly from hearing from the Special Deputy Inspector at Treasury who has direct oversight jurisdiction over this program, who has issued reports that appear to conflict with some of SIGTARP's findings.

Now, my staff contacted the Deputy IG, but she also was unavailable to attend this hearing on such short notice. For this reason, Mr. Chairman, I ask that the IG's report on this program, which was issued in July 2012, also be entered into the record.

Chairman ISSA. Without objection.

Mr. CUMMINGS. I want to make it clear, Mr. Chairman, while we are entering these into the record, I agree with you, we need the testimony. But I want to make sure they are part of the record.

Finally, GAO also has a statutory mandate to review this program's initial reports. Those reports have commended the implementation of this program. Unfortunately, we do not have anyone here from GAO either.

I ask unanimous consent that GAO's reports on this program, which was issued in 2011 and 2012, also be entered into the record.

Chairman ISSA. Without objection.

Mr. CUMMINGS. I look forward to the testimony of Ms. Romero. But what we will hear today is a partial and incomplete assessment of what we have to deal with today. And I look forward, Mr. Chairman, to working with you to getting all of the witnesses that we need so we might thoroughly address this issue.

With that, I yield back.

Chairman ISSA. I thank the gentleman. And we will extend a future invitation. So hopefully those who could not do it in eight days will be aware that they will be invited in the future and perhaps they can start working now.

I also want to associate myself with your comments, this is a technical hearing. This is one in which no laws were broken, but in fact there was a more effective use of funds. And you talked about that very favorably, as I would agree. Then there was a less effective use of funds. It is the impact of that that I believe the IG will testify to.

Members may have seven days in which to submit opening statements, or other extraneous material for the record. I would now like to welcome our witness, the Honorable Christy L. Romero. She is Special Inspector General for the Troubled Asset Relief Program and a returning guest, both in her current position and her previous position.

Pursuant to the rules, if you would please rise and raise your right hand to be sworn.

Do you solemnly swear or affirm that the testimony you are about to give will be the truth, the whole truth and nothing but the truth?

[Witness responds in the affirmative.]

Chairman ISSA. Please be seated.

Let the record indicate that the witness answered in the affirmative.

Because this is the sole panel, we won't hit you with the light and say next witness. But I would appreciate it if you would summarize so we can get to questions. The gentlelady is recognized.

STATEMENT OF THE HONORABLE CHRISTY L. ROMERO, SPECIAL INSPECTOR GENERAL, OFFICE OF THE SPECIAL INSPECTOR GENERAL FOR THE TROUBLED ASSET RELIEF PROGRAM

Ms. ROMERO. Chairman Issa, Ranking Member Cummings and members of the committee, it is my honor today to appear and present SIGTARP's report. I thank the committee for its commitment to oversight and transparency.

TARP was intended to increase lending. But that did not happen and small businesses were left struggling. So Congress viewed SBLF as a fix to TARP, because it gave incentives to lend.

Treasury officials said that banks could leverage each SBLF dollar to make loans in many multiples. As much as \$8 to \$10 in loans could be made for every SBLF dollar.

TARP banks were allowed in SBLF but it was Treasury who had the authority to choose the banks that would be a good fit for SBLF and the amount they would get. Congress had one clear expectation: all banks were expected to increase lending.

SIGTARP's audit is not about whether it was appropriate for Congress to allow TARP banks in SBLF. Our report is about whether Treasury chose the right banks, the right TARP banks to exit TARP and go into SBLF. Nearly 60 percent of TARP small banks applied for SBLF, while only 9 percent of small banks outside of TARP applied for SBLF. This should have been a warning sign that TARP banks were looking at SBLF as a TARP exit strategy.

When Treasury was choosing banks, we recommended that Treasury not count the TARP capital in assessing the health of the bank. What we said was, it made little sense to take a bank out of TARP if it did not have the capital to lend. Treasury rejected our recommendation, and they gave two-thirds of the \$4 billion in SBLF dollars to TARP banks.

Twenty-four TARP banks actually decreased their small business lending while in SBLF. These banks got \$500 million in SBLF, but they decreased their small business lending by \$741 million. Where did the SBLF money go? It did not go to small businesses. Fourteen of these banks paid their shareholders dividends. At least two gave their CEOs a substantial raise, a raise of at least 40 percent. These banks got some of the biggest SBLF investments. At least 24 banks that decreased lending actually got some of the biggest dollars from SBLF. Nineteen got more than \$10 million; ten got over \$20 million from SBLF and two got well over \$50 million from SBLF. But only 12 banks in SBLF got over \$50 million.

This cannot be acceptable. The number of banks that Treasury should have allowed to actually decrease their small business lending in SBLF should have been zero.

TARP banks had much to gain and little to lose from SBLF. There is no penalty for decreasing lending. The banks pay what they would have in TARP.

We looked to see if the TARP banks that were chosen by Treasury increased their lending in many multiples of every SBLF dollar, just as Treasury had promised. We found that was not the case. Forty-two banks that Treasury gave only enough SBLF dollars to repay TARP increased their lending by only 25 cents for every SBLF dollar. These 42 banks got one-quarter of the money in SBLF, they got \$1 billion of the \$4 billion in SBLF. TARP banks as a group collectively increased lending by \$1.13 for every dollar in SBLF funds.

The non-TARP banks that are in SBLF boosted their lending by three times that amount.

The application process was essentially the same as it was for TARP, left over from TARP, which is how one banking regulator

described it to us. It did not make sense to us that repeating the same TARP process would bring a different result.

There is supposed to be one key difference in the application process. Congress put in a lending safeguard; the banks had to submit a plan on how they would increase lending to their banking regulator along with their application to SBLF.

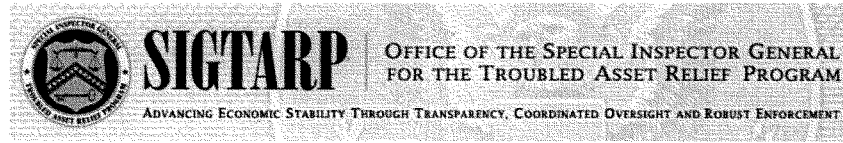
That lending plan should have separated the wheat from the chaff. It should have shown which banks best fit the program's goals, and which would fall short. The first problem, the plans, the template of which were designed by Treasury, were two pages long, not a lot of detail. Second problem, Treasury thought the banking regulators were assessing the plan to see if the lending was achievable, and the banking regulators thought that Treasury was doing it. This lack of accountability resulted in no adequate assessment of the lending plans. There is no consistent, meaningful review of the plans.

Treasury did no independent analysis to determine if the lending could be achieved. They only did a check-the-box, superficial review to see if certain elements were included. This was a lost opportunity to ensure that the right TARP banks that could lend refinance into SBLF. There is another lost opportunity when for two years Treasury did not ask why 24 banks decreased lending.

What can be done? Well, we can't get back the lending that didn't happen to small businesses. But we can focus on the lending that can happen going forward with these banks. We recommended that Treasury help those banks come up with new plans to increase their lending in multiples, as was intended but Treasury rejected that. Unfortunately, it is the small businesses in our communities that have suffered and will continue to suffer unless there is meaningful lending to them.

Thank you again for this opportunity, I am happy to respond to any questions.

[Prepared statement of Ms. Romero follows:]



FOR OFFICIAL USE ONLY UNTIL RELEASED BY THE
U.S. HOUSE COMMITTEE ON
OVERSIGHT AND GOVERNMENT REFORM

STATEMENT OF THE HONORABLE CHRISTY ROMERO
SPECIAL INSPECTOR GENERAL
FOR THE TROUBLED ASSET RELIEF PROGRAM
(SIGTARP)

BEFORE THE
U.S. HOUSE COMMITTEE ON
OVERSIGHT AND GOVERNMENT REFORM

April 24, 2013

Chairman Issa, Ranking Member Cummings and members of the Committee, I am honored to appear before you today to present the Office of the Special Inspector General for the Troubled Asset Relief Program's ("SIGTARP") April 9, 2013 audit report "Banks that Used the Small Business Lending Fund to Exit TARP."

SIGTARP serves as the watchdog over the Troubled Asset Relief Program ("TARP"), the Federal bailout resulting from the financial crisis. SIGTARP protects the interests of those who funded TARP programs – American taxpayers – by conducting criminal investigations and audits. Our mission is to promote economic stability through transparency, robust enforcement, and coordinated oversight.

This Committee is committed to examining the management and effectiveness of Treasury's Small Business Lending Fund ("SBLF"). Lending was a key goal of TARP and SBLF. TARP was intended to increase lending. However, that did not happen and small businesses were left struggling. On February 26, 2010, then-Treasury Assistant Secretary for Financial Stability Herbert Allison testified before Congress in support of the proposed SBLF program, stating that SBLF funds could increase banks' capital by 30-50%, capital that "can be leveraged to support a great deal more in lending." The idea behind SBLF was not simply that the banks would lend out the SBLF funds it received, but instead that they would leverage those funds to make loans in many multiples of the SBLF dollars. In September 2010, Congress authorized Treasury to invest \$30 billion in small banks through SBLF. Viewed by members of Congress as a fix for TARP's failure to require or incentivize banks to lend the money, SBLF provided participating banks with incentives to increase small-business lending.

The scope and scale of SBLF were not as expected. Fifty-eight percent of the community banks in TARP applied for SBLF, while only 9% of the roughly 6,700 community

banks not in TARP applied. Given that TARP status should not have been indicative of loan demand, the wide differential in applications should have been a warning sign to Treasury that TARP banks were looking to SBLF as an opportunity to exit TARP.¹ Treasury only invested \$4 billion of the available \$30 billion, two-thirds of which (\$2.7 billion) went to 137 TARP banks. These TARP banks used approximately \$2.1 billion of the SBLF funds as a vehicle to exit TARP, escape TARP's restrictions on executive compensation and luxury expenditures, and pay less for taxpayer money (in the form of reduced dividends).² As part of its mission of transparency and oversight, SIGTARP conducted an audit to determine whether Treasury and Federal banking regulators consistently evaluated applications submitted by TARP banks to refinance into SBLF.

Although Congress allowed TARP banks to participate in SBLF, it intended that all banks in the program increase their loans to small businesses, and gave Treasury authority to choose which TARP banks best fit the program's goal. Some members of Congress noted that SBLF substantially resembled TARP and expressed doubt that lending would increase. Concerned that some banks may view SBLF as a TARP exit strategy with little benefit to small businesses, in September 2010, SIGTARP recommended that when choosing banks, Treasury not count TARP capital in assessing the health of the bank, stating "it makes little sense to convert a bank into SBLF – a program intended to incentivize increased lending – if the institution does not have the necessary capital to support such increased lending."

¹ In a 2011 GAO survey, some TARP banks cited the opportunity to exit TARP as the primary reason for applying for SBLF funds.

² In addition, when discussing in press releases and blog posts how much Treasury has received in TARP repayments, Treasury includes the more than \$2 billion of SBLF funds that banks used to repay TARP. In a letter to Secretary Geithner, Senator Chuck Grassley asked Treasury to ensure that TARP funds repaid by SBLF not be counted as funds repaid to the Government.

SIGTARP continued, “An institution that would not have an adequate capital base but for the Government’s investment likely will not have the necessary capital to support increased lending.” SIGTARP designed the recommendation not to penalize TARP banks, but to ensure that banks did not use SBLF to escape TARP, and its restrictions, without effectively increasing small-business lending, a concern that unfortunately has come to fruition.

SBLF Has Not Effectively Increased Lending by Former TARP Banks that Used SBLF To Exit TARP

Former TARP banks in SBLF have not effectively increased small-business lending because they used approximately 80% of SBLF funds (\$2.1 billion of the \$2.7 billion) to pay off TARP, rather than to increase lending. Twenty-four TARP banks actually decreased their small business lending by \$741 million while in SBLF, which was more than the \$501 million they received in SBLF.³ Furthermore, 14 of these 24 former TARP banks paid dividends to shareholders while in SBLF, despite decreasing their small business lending. Given that SBLF’s sole goal was to increase small business lending, the number of banks that Treasury should have allowed to decrease their lending in SBLF after two years should be zero.

TARP banks had much to gain and little to lose from refinancing into SBLF irrespective of their small-business lending capability or willingness to lend. If the former TARP banks fail to increase lending, there is no meaningful penalty. The “fees” and “penalties” resulting from a TARP bank’s failure to increase lending in SBLF bring the cost of capital in line with the cost under TARP.⁴

³ The source for all SBLF lending data used in this report is Treasury’s *Use of Funds Report*, published on January 7, 2013, that reflects SBLF lending as of September 30, 2012, the latest data available at the time SIGTARP drafted its report. At that time, 132 of the 137 TARP banks remained in SBLF, five had paid off SBLF and exited the program.

⁴ If the bank had remained in TARP, it would pay a 5% dividend for each of five years, after which (in 2013 or 2014) the rate would increase to 9%. If a TARP bank that refinanced into SBLF fails to increase

Treasury determined that as a matter of policy, both TARP and non-TARP banks applying to SBLF would have to project lending growth at least equal to the amount of SBLF funds they received; however, that was the minimum, and Treasury expected banks that received SBLF funds to increase lending in multiples of every SBLF dollar. In a March 16, 2010 hearing before the House Committee on Appropriations, former Treasury Secretary Geithner testified about the proposed SBLF program stating that, “the capital could be leveraged several times into new loans.” He further testified, “one of the best use of a dollar of scarce resources is capital to a small bank because that will turn into \$8 to \$10 in additional lending capacity.” In a press release, Treasury announced that it was investing more than \$4 billion to “help propel lending by Main Street banks in many multiples of that amount.” On October 18, 2011, former Treasury Secretary Timothy Geithner testified at a hearing on a review of the Small Business Jobs Act by the Senate Committee on Small Business and Entrepreneurship on, that SBLF (and TARP) investments in banks “are by any measure one of the most efficient uses of taxpayers’ money we have because every dollar of capital you make available to a bank who can’t get capital from other sources is worth somewhere between \$8 and \$10 of lending capacity.”⁵

SIGTARP conducted an analysis to determine whether TARP banks increased small business lending in multiples of every SBLF dollar, in line with Treasury’s statements

its small-business lending after two years, its dividend rate will increase by 2 percentage points from, 5% to 7% (in 2014). In addition, if a SBLF bank fails to increase lending after the bank’s 9th quarter in SBLF, there would be a 2% “lending incentive fee” to 9% on the fifth anniversary of the TARP investment.

⁵ Some members of Congress believed that lending had the potential to increase by multiples of ten, stating that SBLF would lead to \$300 billion in new small-business loans because the banks would be able to lend as much as \$10 for every \$1 in SBLF funds. Senator Maria Cantwell, a member of the Senate Committee on Small Business and Entrepreneurship, quoted an estimate by the Independent Community Bankers of America that the \$30 billion SBLF fund will generate up to \$300 billion in small-business lending. In June 2010, Congresswoman Melissa Bean cited a Congressional Budget Office estimate that SBLF “can be leveraged by banks into over \$300 billion in new small-business loans,” based on SBLF’s potential as a \$30 billion small-business investment fund.

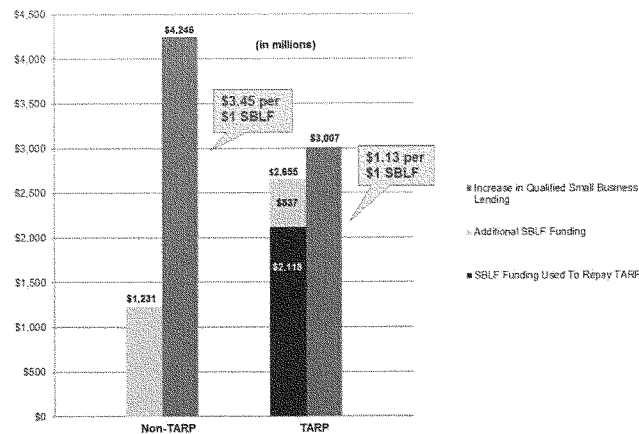
and policy. This simple method shows the value the SBLF banks are providing to taxpayers and takes into account the taxpayer dollars invested in the banks; something not provided just looking at loan growth. While any increase in lending is helpful, not all lending increases deliver the same degree of value to taxpayers, particularly in light of the fact that small business lending at TARP banks had declined so much during the crisis.

Beyond the 24 banks that decreased lending while in SBLF, the remaining TARP banks in SBLF increased lending, but they significantly underperformed compared with non-TARP banks. Former TARP banks in SBLF increased lending by just \$1.13 for each \$1 in SBLF funds they received (a multiple of one for every SBLF dollar). By comparison, banks that did not participate in TARP but received SBLF funding have increased small-business lending by more than three times that amount – \$3.45 for each \$1 in SBLF funds (a multiple of three for every SBLF dollar).

Figure 1 shows a comparison of SBLF funding levels and lending increases of TARP banks and non-TARP banks.

FIGURE 1

DIFFERENCES IN INCREASES IN LENDING BY TARP AND NON-TARP BANKS IN SBLF



Note: Increases are calculated as the difference between Qualified Small Business Lending as of September 30, 2012, and the quarterly average of these loan balances for the four quarters preceding the legislation's passage (the same "baseline" period used by the program to calculate lending growth).

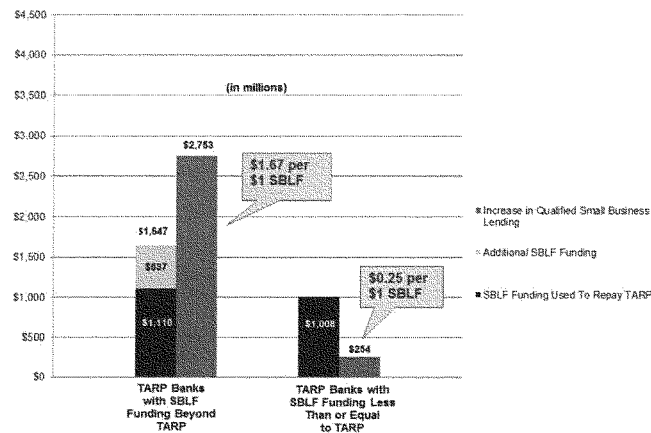
Source: SIGTARP analysis based on Treasury's SBLF *Transactions Report* as of December 31, 2012, and Treasury's *Use of Funds Report*, data as of September 30, 2012.

Although as a group, the former TARP banks remaining in SBLF increased lending by \$1.13 for each \$1 in SBLF funds received, there was a significant difference in lending depending on whether the bank received only enough SBLF funds to repay TARP or received additional funds.

SIGTARP found that 42 TARP banks that received only enough SBLF funds to pay off TARP have lent out significantly less than they received in SBLF funds – increasing lending by only 25¢ for each \$1 in SBLF funds. If Treasury had implemented SIGTARP's 2010 recommendation, it could have addressed the obvious question about these banks' ability

to meet the SBLF's program's lending goal if all the SBLF funds they received would be used to repay TARP. TARP banks that received additional money beyond the outstanding TARP balance have increased lending by \$1.67 for every \$1 in SBLF funds. Therefore, TARP banks in SBLF have not propelled lending in many multiples of the amount of SBLF funds they received, as Treasury promised. Figure 2 shows differences in lending increases in former TARP banks in SBLF that only received enough SBLF funds to repay TARP compared to those that received additional SBLF funds.

FIGURE 2
DIFFERENCES IN INCREASES IN LENDING BY TARP BANKS IN SBLF,
BASED ON AMOUNT OF SBLF FUNDING



Note: Increases are calculated as the difference between Qualified Small Business Lending as of September 30, 2012, and the quarterly average of these loan balances for the four quarters preceding the legislation's passage (the same "baseline" period used by the program to calculate lending growth).

Source: SIGTARP analysis based on Treasury's SBLF Transactions Report as of December 31, 2012, and Treasury's Use of Funds Report, data as of September 30, 2012.

Treasury and Federal Banking Regulators Did Not Adequately Assess Whether Banks' Plans To Increase Small-Business Lending Were Actually Achievable

Treasury had the ability to exclude TARP banks that were not a good fit for the SBLF program. Congress' safeguard of requiring that banks submit a small-business lending plan, a requirement not present in TARP, did not have the intended effect because Treasury and the Federal banking regulators did not adequately assess whether the banks' plans to increase small-business lending were achievable.⁶ Overall, Treasury and regulators did not conduct consistent, meaningful reviews of the plans focusing on whether the TARP banks were prepared to lend SBLF capital. SIGTARP found that, during the application review process, regulators did not consistently provide adequate input to Treasury on the SBLF lending plans and generally did not scrutinize the credibility of the information presented in the lending plans, focusing instead on the applicant's viability.

Treasury's application review process was almost entirely focused on the banks' ability to repay the funds to Treasury, overshadowing any consideration of the applicants' preparedness to lend SBLF money. Treasury determined that as a matter of policy, both TARP and non-TARP applicants would have to project lending growth at least equal to the amount of SBLF funding they received. However, Treasury did not adequately evaluate the credibility of those projections, limiting the effectiveness of that policy. Absent consistent and meaningful scrutiny by Treasury or regulators of banks' lending plans, some institutions refinanced from TARP into SBLF seemingly unable to fulfill the sole purpose of the program – to increase lending to small businesses.

⁶ The Federal banking regulators are the Federal Reserve Board ("Federal Reserve"), the Federal Deposit Insurance Corporation ("FDIC"), and the Office of the Comptroller of the Currency ("OCC").

Treasury & Federal Banking Regulators Did Not Effectively Communicate with Each Other; Each Relied on the Other To Assess the Banks' Plans To Increase Lending

Lending plans submitted by SBLF applicants did not receive appropriate and consistent Government scrutiny during the application review process in part because Treasury and Federal banking regulators did not collaborate effectively with each other, each claiming that the other had responsibility to assess the lending plans. Treasury's SBLF program director told SIGTARP that Treasury did not perform an independent analysis of the projections in the lending plans, a statement borne out by SIGTARP's document review. He told SIGTARP that the analysis of the lending plans was the regulators' responsibility, rather than Treasury's, because the Jobs Act required that the lending plans be submitted to regulators.

Regulators, however, did not agree with Treasury's view, and OCC and FDIC officials told SIGTARP that they perceived their role to be that of a conduit, passing along the lending plans to Treasury. SIGTARP asked Federal Reserve's Manager of Community Banking Organizations whether the Federal Reserve had considered whether the lending goals reported in TARP applicants' lending plans were attainable when some institutions used all the SBLF capital they received to repay TARP. He responded that such consideration was the responsibility of Treasury, not the regulators. The result of this lack of effective communication was an overall lack of scrutiny by Treasury and regulators to determine whether the banks' plans were credible. Notably, Treasury and regulators did not deny SBLF funding to any TARP bank based on its lending plan.

Regulators Did Not Consistently Take Action To Preserve the Intent of Congress and SBLF by Meaningfully Reviewing the Banks' Proposals To Increase Lending

During the SBLF application review process, regulators missed opportunities to protect the interests of taxpayers because they did not ensure that the banks were prepared to lend SBLF funds to small businesses consistent with the intent of Congress. Given their institutional expertise as bank supervisors, regulators were well suited to weigh in on the credibility of the applicant banks' plans to increase small-business lending. Instead regulators generally focused on the banks' viability, in a process described by one regulator as "left over" from TARP. Despite the fact that the law that created SBLF required that applicants submit a small-business lending plan to their Federal banking regulator, regulators did not consistently take action to preserve the intent of Congress by meaningfully reviewing the banks' proposals to increase lending. Even where the regulator provided input to Treasury on the lending plans, the regulator did not recommend that Treasury deny funding to the TARP bank based on the lending plan, and former TARP banks have not effectively increased small-business lending.⁷

⁷ SIGTARP found that, during the application review process, regulators did not review banks' plans to increase lending in the same manner. According to an FDIC official interviewed by SIGTARP, the FDIC (who regulated 69% of the TARP applicants) did not analyze the lending plans and served only as a conduit to Treasury. FDIC guidelines instructed its staff that no input was necessary unless the plan presented safety and soundness concerns. An OCC official told SIGTARP that OCC viewed itself as a conduit for the lending plan, with Treasury having primary responsibility for lending plan review, and OCC weighing in on reasonableness. The Federal Reserve's review of lending plans appears to have differed depending on whether it was the primary regulator of the bank or the regulator of the bank holding company (who received the funds). A Federal Reserve official told SIGTARP that the Federal Reserve focused on the impact of the plan on the safety and soundness of the bank, not on the adequacy and achievability of the proposed lending, and deferred responsibility to FDIC or OCC, which regulated the subsidiary bank. In these statements, the official is referring to applicants where the Federal Reserve regulated the bank holding company, but not the subsidiary bank. In addition, in SIGTARP's review of 32 applications by TARP banks for SBLF, the FDIC only provided input to Treasury on the applicant lending plans for 4 of 23 FDIC-regulated banks, the OCC provided input on 5 of 5 OCC-regulated banks, and the Federal Reserve provided input to Treasury on the lending plans of only 7 of the 27 banks where


Treasury's Review of Banks' Plans To Increase Lending Was Superficial and Employed a "Check-the-Box" Review

Even with limited input from the regulators on banks' proposed lending plans, the plans could have been adequately assessed had Treasury's own review been substantive. Instead, Treasury's application review process was almost entirely focused on the banks' ability to repay the funds to Treasury, overshadowing any consideration of the applicant's preparedness to lend SBLF money. Treasury's review of the lending plans submitted by SBLF applicant banks was superficial, with Treasury merely filling in a "check-the-box" review form that did not provide specific details to support the applicant's ability to increase lending as proposed. Treasury's evaluation of the lending plans as seen in its Small Business Lending Fund Lending Plan Evaluation reproduced in Figure 3 focused on form over substance, scoring the banks on how many of the 12 elements the bank included, assigning equal weight for the bank's description of its use of media outlets for outreach as it did for describing its emphasis on small-business lending.⁸ Treasury gave little to no consideration to key risk factors, such as the source of funds to support new lending, despite obvious questions about TARP banks' ability to meet the SBLF program's lending goals for those banks that would use SBLF funds to repay TARP.

the Federal Reserve regulated the bank holding company and all 4 applicant banks primarily regulated by the Federal Reserve.

⁸ Treasury did not require the banks to provide other information that would be helpful to assess the credibility of whether the banks could achieve their proposed increases in lending. For example, plans could pass review without TARP banks describing where they would get the funds to lend, how small-business lending fit within banks' lending, or without specifying the amount of resources banks planned to devote to small-business lending. In addition, SIGTARP's review of meeting minutes and documentation for its review of 32 TARP banks that applied for SBLF evidences that, for those banks, Treasury officials generally did not assess whether the banks' plans to increase small-business lending were achievable. Treasury invested SBLF funds in some banks, even though the banks submitted lending plans that were deficient on their face. In its review of 32 applications, SIGTARP found obvious deficiencies in lending plans that Treasury and Federal banking regulators should have caught, even in a superficial review.

FIGURE 3
TREASURY'S SMALL BUSINESS LENDING FUND LENDING PLAN
EVALUATION FORM

Small Business Lending Fund Lending Plan Evaluation		
Institution Name: _____	Date: _____	
SBLF Identification Number: SBLF _____	MANDATORY LENDING PLAN ELEMENTS Small Business Loan Growth (N/A): _____ (Questions 5, 7) Business Lending History (N/A): _____ (Questions 5, 7)	
Current Business Lending as % of Total Loans: _____ %	PLAN SUFFICIENCY SCORE: <u>1/2</u> (Questions 1.1 - 1.4)	
Amount Requested: _____	CPP Reference: <input type="checkbox"/> N <input type="checkbox"/> Y	
1. Mandatory Lending Plan Elements		
1.1 Is projected sm. bus. lending increase greater than or equal to amount requested? <input type="checkbox"/> 0 <input type="checkbox"/> 1		
1.2 Is current small business lending, as reported on the 12/31/20 call report, greater than 10% of total loan? If not, does lending plan contain market entry plan? <input type="checkbox"/> 0 <input type="checkbox"/> 1		
2. Analysis of how SBLF participation will enable the bank to better address needs of small business		
2.1 Market Analysis:		
2.1.1 Describe communities served by the bank and/or lending needs. <input type="checkbox"/> 0 <input type="checkbox"/> 1		
2.1.2 Contains quantitative assessment of loan demand (by loan or business type). <input type="checkbox"/> 0 <input type="checkbox"/> 1		
2.2 Small Business Loan Production Experience:		
2.2.1 Describes historical small business lending experience. <input type="checkbox"/> 0 <input type="checkbox"/> 1		
2.2.2 Describes participation in SBA/USDA/state small business lending activities. <input type="checkbox"/> 0 <input type="checkbox"/> 1		
2.3 Small Business Lending Infrastructure:		
2.3.1 Describes bank's resources dedicated to small business. <input type="checkbox"/> 0 <input type="checkbox"/> 1		
2.4 Emphasis on Small Business Lending:		
2.4.1 Contains description of small business lending within the bank's overall corporate strategy and business objectives. <input type="checkbox"/> 0 <input type="checkbox"/> 1		
3. Analysis of how the bank would conduct outreach activities to increase small business lending.		
3.1 General Media Outreach:		
3.1.1 Describes use of general media outlets (print, radio, television, electronic). <input type="checkbox"/> 0 <input type="checkbox"/> 1		
3.2 Culturally Appropriate Media Outreach:		
3.2.1 Instructs target individuals that represent, work with, or are: women, minorities, or veterans - OR uses media outlets that do. <input type="checkbox"/> 0 <input type="checkbox"/> 1		
3.3 Community Outreach:		
3.3.1 Describes membership and participation in community organizations and/or trade associations. <input type="checkbox"/> 0 <input type="checkbox"/> 1		
3.4 Linguistically Appropriate Outreach:		
3.4.1 Describes use of staff or outreach materials intended for multilingual audience. <input type="checkbox"/> 0 <input type="checkbox"/> 1		
Notes:		
Analyst's Signature _____	Date _____	
Reviewer's Signature _____		

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Source: Treasury.

Congress intended that SBLF fix the significant lost opportunity in TARP that banks were not required or given incentives to lend. The lending plans were the safeguard to provide that fix, but without consistent, meaningful review of those plans by Treasury and the Federal banking regulators, there was no substantive difference between TARP's application review process and SBLF's application review process for TARP banks, as it related to lending. Many of the TARP banks that refinanced into SBLF are demonstrating an inability or unwillingness to fulfill the sole purpose of the program – increase lending to small businesses. Many TARP banks may not have had the wherewithal to increase lending because they used their SBLF funds to repay TARP. Other TARP banks may not have received enough additional funds to achieve the increases in lending they proposed. Treasury and regulators would have detected this with proper and consistent scrutiny of applicants' lending plans and required the banks to demonstrate a source of funds to lend. If the banks could not credibly demonstrate a source of funds to lend beyond the SBLF funds they used to repay TARP, Treasury should have found the banks unsuited to participate in the program and kept them in TARP.

Unlike TARP's first bank program, which was created during an emergency, SBLF was not designed in the same crisis mode that existed in 2008. Treasury and regulators had a year to develop and implement meaningful SBLF application review procedures that would achieve the intended purpose of promoting lending. By not doing so, Treasury and the regulators lost sight of Congress' primary goal of the program – to increase lending to small businesses. Treasury and the regulators should have assessed the credibility of the information provided by each applicant TARP bank in its lending plan to ensure that those banks exiting TARP through SBLF were well positioned and well prepared to meet SBLF's sole purpose to increase lending to small businesses. At a minimum, Treasury and the

regulators should have required TARP bank applicants to identify another source of capital to increase lending when the institutions sought to use all of the SBLF capital they received to repay TARP. If these TARP banks had been unable to demonstrate a credible source of capital to lend, regulators and Treasury may have identified some of the applicants as unsuited to exit TARP using SBLF funds. Had these banks remained in TARP, they would have been subject to TARP's limitations on executive compensation, luxury expenditures, and cumulative dividends at a higher payment to taxpayers. Instead, SBLF served as a vehicle for a significant number of TARP banks to exit TARP using Government funds with more favorable terms than TARP with little resulting benefit for small businesses.

Lessons Learned & SIGTARP Recommendations

In conducting this audit, SIGTARP identified a lack of effective coordination and communication between Treasury and the Federal banking regulators. Early communication and coordination of which entity was responsible for assessing the credibility of banks' lending plans would likely have ensured the effectiveness of the lending plans – Congress' critical safeguard to ensure that banks lent the money. Implementing appropriate corrective action could prevent Treasury and regulators from repeating past mistakes in future collaborative endeavors. SIGTARP recommended: (1) that Treasury and the Federal banking regulators coordinate when collaborating on current and future initiatives by defining roles and documenting processes; (2) that Treasury work with the banks to establish new, achievable plans to increase lending going forward; and (3) to preserve the capital former TARP banks participating in SBLF have to lend, the primary Federal banking regulators should not approve dividend distributions to shareholders of former TARP banks that have not effectively increased small-business lending while in SBLF.

Treasury disagreed with SIGTARP's audit findings, relying on the lending that has happened, without addressing the lending that has not happened. This is the equivalent of Treasury focusing on the 862,000 homeowners active in a HAMP permanent mortgage modification, rather than focus on the 3 to 4 million homeowners who were supposed to be helped by HAMP, many of whom could still be helped by HAMP. It is unfortunate for small businesses that Treasury's response to SIGTARP's report is to take a defensive posture and reject SIGTARP's recommendations. Treasury shows no realization that more can be done, or that change is needed to the status quo. The actions SIGTARP recommends are prudent and not difficult to accomplish. TARP banks in SBLF need help from Treasury to work on new small-business plans to achieve their promise to increase small business lending.

Chairman Issa, Ranking Member Cummings, and members of the Committee, thank you again for this opportunity to appear before you, and I would be pleased to respond to any questions that you may have.

Chairman ISSA. Thank you.

I will recognize myself first. Could you put the form up on the screen, please? That is the form you are talking about?

Ms. ROMERO. That is correct.

Chairman ISSA. So it looks like SAT, but with only two boxes, not four or five boxes to check. It is a zero or 1 relationship. So all somebody had to do is give themselves the appropriate answer, a zero or 1, and they were done, is that right?

Ms. ROMERO. It was very superficial, just check the box if the information was there.

Chairman ISSA. That is a million dollar plus decision on a one-page.

I would like to show the video in context, not to mock or be unfair to the President, or the Secretary. But I think it puts in context the promise made versus what was kept.

[Video shown.]

Chairman ISSA. Now, in fairness, I want to ask the question divided. Could the banks that were not coming out of TARP, in which this was net new dollars, at about 1 percent interest rate, very favorable interest rate, were the President's goals and the Secretary's statements confirmed?

Ms. ROMERO. I think they are well on their way. This program takes a little bit of time. They are already at \$3.45 increased lending for every dollar.

Chairman ISSA. The goal of getting to \$8 or \$9 is still there, but essentially though, for every dollar we put in, we got \$3 in lending and we got a net increase.

So substantially, it did get out quickly and it did get out and do good where it went to banks that had net new dollars to lend, is that right?

Ms. ROMERO. That is right.

Chairman ISSA. In your testimony, isn't the real problem here net new dollars versus taking a 5 percent interest rate and dropping it to 1 percent and saving the difference? That seems to be the difference between whether I take TARP, pay it back and then take money that costs me less, but have no net new dollars. That seems to be really what we are talking about here, is the use of funds was TARP and savings, rather than any kind of net increase.

Ms. ROMERO. That is why we had recommended, when Treasury was choosing the banks that they not count that TARP capital. They needed the banks to stand on their own capital, just like every other bank applying would.

Chairman ISSA. So by paying back the TARP capital, they really not only were standing on their TARP capital, but they were replacing it with this money. So these were banks that because they still had TARP, in a sense they were underfunded.

Ms. ROMERO. Well, for the banks that decreased lending, either maybe they weren't the right banks to get into the program, or Treasury could have given them a little more money to try to give them additional capital to leverage funding out. It was Treasury that made the decision to choose the bank and how much funding they would get.

Chairman ISSA. Were any of these banks banks that did not pass the stress test that essentially were either close to or below the initial mark?

Ms. ROMERO. Well, no, because the stress test is for the largest banks and these are the smaller banks.

Chairman ISSA. So these banks could have been over leveraged, not over leveraged, that wasn't part of the test?

Ms. ROMERO. No. Those were things that should have been looked at.

Chairman ISSA. So we could have had banks that got TARP money, needed TARP money and were on the edge, and as a result they just simply needed that, essentially leverage improvement, because what they got was, they got a lower interest rate which went right to the bottom line, 4 percent of a million dollars is \$40,000 real benefit, is that right?

Ms. ROMERO. If they don't increase their lending at all, then they just pay the same as they would in TARP, which is 5 percent. But in TARP, after five years that jumps to 9. Even if you increase, if you are in SBLF, even if you increase by a dollar, you are not going to get that 9 percent jump.

Chairman ISSA. But if you decrease by \$1.13, essentially 13 cents of increase, you were paying 1 percent on that money, weren't you?

Ms. ROMERO. Yes. It dropped down for each bank. Each bank is a little bit different. But basically there are these tiered stages. All you have to do is lend like a minimum of 2.5 percent increase to get a drop. Some of these had very, very low thresholds. So to do increases of 2.5 percent, 5 percent, 10 percent, for somebody that is a low bar. Everything is helpful, not everything is meaningful.

Chairman ISSA. But if I got several million dollars and I got out of TARP, I got an interest rate drop of some amount and I got to increase my pay as the CEO of a bank above what would otherwise have been limited by act of Congress?

Ms. ROMERO. That is right, you escaped all of TARP's restrictions and luxury expenditures.

Chairman ISSA. I can see why a bank would do that.

Let me just ask one last question. This audit question. I want to understand. You had a choice between Treasury doing it, essentially you had two places to audit, and each party thought the other was doing it. So in a sense there was no audit, is that correct, that you had one group that should have done it, or the other group that should have done it, each said, I thought the other was doing it? So what we had was a failure to audit that somewhere somebody didn't notice until you brought it up?

Ms. ROMERO. Yes, it was very compelling to hear, as we interviewed each regulator individually, to hear that they thought the others had done it.

Chairman ISSA. Let me just ask a follow-up to that very, very quickly. Bank regulators do not ordinarily do this kind of audit except on the behest of Treasury. So in a sense, wasn't it Treasury's primary responsibility to see that the audit got done or to do it? It was not inherent of bank regulators audit, but it certainly is something Treasury could have tasked them with, or did it themselves?

Ms. ROMERO. This is certainly Treasury's program and they take responsibility. But I do have to lay a little bit of responsibility on the banking regulators because the lending plans under the statute were actually given to them, submitted to them. They were probably in the best position. But ultimately it was Treasury's job and responsibility to make sure that it happened, because they were running the program.

Chairman ISSA. Thank you.

The ranking member is recognized.

Mr. CUMMINGS. Thank you very much. I want to make sure, first of all, I want to thank you for your report. But I want to make sure that we have, I guess in Steve Harvey's language, the rest of the story. Because there are different ways to look at the same information.

But I want to go back for a moment. How many banks are we talking about and how many decreased their lending?

Ms. ROMERO. There were 137 TARP banks that were in SBLF. Twenty-four decreased the lending. Now, 24 may sound small. But when you look at the dollar amount, it is a large amount. These were some of the largest. You had a couple banks, two banks in that group, for example, that got more than \$50 million and only 12 banks in SBLF got more than \$50 million. So you have 10 that got over \$10 million, 19 that got over \$10 million. So while 24 may look like a small number, the significance is how many that they got \$500 million under the program.

Mr. CUMMINGS. I believe very strongly, there are two words that I use in my office most often, effectiveness and efficiency. It sounds like that that is what we are going to. But around here, we have a tendency, Ms. Romero, sometimes to, we get reports or whatever and then certain things are pulled out and they become the headlines. And a lot of times, we have what I call collateral damage, of people who did not do anything wrong. As a matter of fact, did everything right, and don't always get the credit. Usually if there is any kind of correction, it is on page 33 at the bottom paragraph.

So I try to make sure that we have the entire story here.

Now, the title of today's hearing is Backdoor Bailout. And the implication is that there is something wrong with small community financial institutions obtaining funds under this program and then refinancing some of their TARP obligations back for bailout. That is the title of the hearing. See, you have to understand the climate we are operating in here. It is a little different than your office.

So let's set the record straight. When Congress passed the Small Business Jobs Act of 2010, we explicitly authorized this. Let me read exactly what the law says, we did this, the Congress did this. The law says, "The Secretary shall issue regulations and other guidance to permit eligible institutions to refinance securities issued to Treasury under the CBCI and the CBP for securities to be issued under the program."

Ms. Romero, the CBCI and the CBP are programs under TARP, is that right?

Ms. ROMERO. That is correct.

Mr. CUMMINGS. So Congress expressly authorized these small community banks to refinance their TARP funds, is that right?

Ms. ROMERO. That is correct. That is not what our report is about.

Mr. CUMMINGS. Well, I am asking the questions. So far, these banks have been doing a terrific job in paying back these funds. As I understand it, all of the banks that receive funds under this program are repaying them appropriately and not one of them has missed a quarterly dividend payment. According to Treasury's most recent estimate, the American taxpayers are set to make a profit of \$50 million on this program.

Now, I would imagine you would say that we could have done even better, is that right?

Ms. ROMERO. No, I don't think that is the point.

Mr. CUMMINGS. Okay, but do you agree with what I have said so far?

Ms. ROMERO. I have not looked over the whole program.

Mr. CUMMINGS. You haven't looked at how much money we are making, the profit?

Ms. ROMERO. No. What I looked at is, just like I looked for the largest banks, how TARP banks exited TARP, I looked to see how TARP banks exited TARP through this program. So that is what I was looking at. That is what we were focused on.

Mr. CUMMINGS. I got you. So let me ask you about a report that GAO issued after evaluating this program. GAO's report said this: "Treasury's process for evaluating SBLF applicants included several levels of review and input from multiple sources to help ensure that applicants were treated consistently and that banks approved for funding were financially viable and could repay the investments."

Do you disagree with GAO's report, that finding?

Ms. ROMERO. Well, I do not know if GAO looked at the analysis, and if there was any independent analysis on the lending plans. But I can tell you that what we found is in the application process there was no independent analysis of the lending plans by Treasury to see if the lending was achievable. That would have applied for all banks.

I also don't know, I don't believe GAO looked at the difference between lending at TARP banks and lending at non-TARP banks.

Mr. CUMMINGS. Mr. Chairman, before you do that, please, may I request unanimous consent to have the same amount of time that the Chairman had, which is about an extra 1.5 minute? Okay. I saw you putting your light on.

Mr. MCHENRY. [Presiding] Sure, I ask unanimous consent the gentleman has an additional minute and 15 seconds. Without objection, so ordered.

Mr. CUMMINGS. Thank you very much.

Ms. Romero, the program also has been audited by the Special Deputy Inspector General within the Treasury Inspector General's office. All of these offices are very reputable offices. The Deputy IG issued a reporting finding that the Department "consistently approved institutions that would likely meet their financial obligations to the SBLF program." Do you agree with the Deputy IG?

Ms. ROMERO. Again, we were able to do something that maybe, then maybe some others. If you just look at Treasury and their application process, you might get one view of it. It was when we

looked at Treasury and every single one of the banking regulators together, because they were all part of the process, that we saw where each thought the other had responsibility for analysis of the lending plan. So I am not exactly sure that the Treasury IG could see that. That is why it was so important, as we were looking at how TARP was being exited, that we were able to go in and interview those people, look at their documents in terms of the regulators. That is where things fell through the cracks, is in the lending plan.

Mr. CUMMINGS. Thank you very much.

Mr. Chairman, that is why it is important that we get the Treasury folks in here. Because you get one piece, but you have to have the whole picture. It is like trying a case with just one side.

Mr. MCHENRY. The gentleman's time has expired. The chair has been generous with him. And just to note for the record again, Treasury was invited and given ample opportunity to participate. They refused, even to the point where their existing report would be allowed to be a testimony in response to Ms. Romero's report and the SIGTARP's report.

With that, I will now recognize myself for five minutes. Ms. Romero, under the scenario that the ranking member painted, would these banks have paid more back under TARP than under the SBLF back to the Treasury, back to the taxpayer?

Ms. ROMERO. Yes. For the banks who did not, who decreased their lending, or did not significantly increase their lending, yes.

Mr. MCHENRY. Therefore, this profit would have been a greater profit had they not been moved into the SBLF?

Ms. ROMERO. They would have paid more in dividends.

Mr. MCHENRY. Thank you. So with this line of this question here, the pledge was that these SBLF banks would lend more to small businesses than TARP banks. Did that prove true?

Ms. ROMERO. I am sorry, would the banks increase their lending to small businesses?

Mr. MCHENRY. Right.

Ms. ROMERO. Are you asking if they would have increased their lending to small businesses in TARP?

Mr. MCHENRY. Well, no, compare a TARP bank to a Small Business Lending Fund bank.

Ms. ROMERO. I apologize. Yes. In the Small Business Lending Fund, there is no question you were supposed to increase your lending. You certainly weren't supposed to take the money and decrease your lending.

Mr. MCHENRY. Okay. So then the question is, the performance of these SBLF banks, these Small Business Lending Fund banks, right?

Ms. ROMERO. Right.

Mr. MCHENRY. The statute requires the banks to submit a small business lending plan, correct?

Ms. ROMERO. Yes.

Mr. MCHENRY. So there was a requirement in statute that the Treasury demand this plan. Did Treasury deny a single bank or any bank, or what is the number of banks that Treasury denied for not having an adequate small business lending plan?

Ms. ROMERO. None. There were some who did not include information so didn't pass the check-the-box. They would then resubmit that information. So no bank was denied funding based on their lending plan.

Mr. MCHENRY. Based on an insufficient or inadequate small business lending plan?

Ms. ROMERO. I will say it this way, based on a lending plan where the bank could not achieve the lending increases that they proposed.

Mr. MCHENRY. So what was the level of scrutiny by Treasury of having a small business lending plan in order to be in the Small Business Lending Fund?

Ms. ROMERO. It was not adequate at all. They did no independent analysis to see if the lending was achievable.

Mr. MCHENRY. So you are saying that the performance did not meet the statute required by Congress and signed by the President?

Ms. ROMERO. Yes. You can't have banks in the program who decrease their lending.

Mr. MCHENRY. Interesting. So the idea that we could actually take banks out of TARP and TARP oversight with a greater return to the Treasury and by the way, the taxpayer, to take them into a different plan that has the very politically popular term, Small Business Lending, included in it, that is interesting. So if you think about the returns based on this, TARP banks lent out how much per dollar in the Small Business Lending Fund?

Ms. ROMERO. Total TARP banks increased their lending by \$1.13 for every SBLF dollar.

Mr. MCHENRY. So what is the comparison here? How can I compare it? Is that good?

Ms. ROMERO. Non-TARP banks increased their lending by \$3.45 for every SBLF dollar. So it is three times the amount.

Mr. MCHENRY. Okay. Because clearly, Congress put this in statute, the President touted. Chairman Issa showed this video. Clearly, this can't be the case.

Ms. ROMERO. This is absolutely the case.

Mr. MCHENRY. So you are telling me a non-participating bank actually increased their small business lending more than a participating bank in the Small Business Lending Fund?

Ms. ROMERO. Yes, and not only should it have been obvious that the money would be used to repay TARP, we warned Treasury that this would happen, that this could happen. We made a recommendation in September 2010 that said, when you choose the banks, don't count the government capital in determining the health of that bank. Because they have to have capital that they can leverage into loans.

Mr. MCHENRY. Certainly. So can the Treasury require under-performing banks to actually develop plans?

Ms. ROMERO. Absolutely.

Mr. MCHENRY. Have they?

Ms. ROMERO. No. We made the recommendation in the audit and they rejected it.

Mr. MCHENRY. And in response to your audit, do they say, thanks so much, thanks for letting us know, we are going to shape up, we are going to do this?

Ms. ROMERO. No, unfortunately they took a very defensive posture. They focused on the lending that has happened in the program, when that is sort of like in HAMP, focusing on the homeowners who have gotten help but not focusing on the homeowners that should have gotten help, that were intended to get help. That is what we are trying to do. We are trying to say, don't give up on these banks now. There is still an opportunity to help small businesses with these non-TARP banks. So work with them to do that. But that was rejected.

Mr. MCHENRY. My time is expired, but you said the word HAMP. So that of course raises my ire based on that poor performance and what it has done to folks it was intended to help.

Now we will recognize Mr. Clay of Missouri.

Mr. CLAY. Thank you, Mr. Chairman.

Let me thank the witness for being here today. When Congress authorized \$30 billion to establish the Small Business Lending Fund, we intended to provide an incentive to community banks nationwide to increase their small business lending. Banks were eligible to apply for SBLF as long as they met the legal requirements. Banks that were not paying their TARP dividends were not eligible to apply.

Ms. Romero, your report raises a concern about the fact that only 935 community banks applied to SBLF when there are approximately 7,000 community banks that could have been potential applicants. Can you please elaborate on that number and why there were so few?

Ms. ROMERO. Sure. The number is about 9 percent of community banks that were not in TARP applied, while about 60 percent of community banks in TARP applied. Why that is the case, I can't elaborate on, sir. I wish I could. But all I have looked at in this program is how TARP banks exited TARP. So I haven't looked at, I don't have jurisdiction over the whole program to say, how was it marketed in the beginning or what was set up in the beginning. I am only looking at the decisions that were made to take banks out of TARP, because I am the Special Inspector General for TARP.

Mr. CLAY. I heard you mention that some of these banks repaid TARP with SBLF funds.

Ms. ROMERO. Yes.

Mr. CLAY. How did they? They got TARP money then they took SBLF, and decided that they were going to repay the money they owed taxpayers, basically, with this money. Is that a shell game?

Ms. ROMERO. Well, that was okay. Congress allowed that. And we are not taking issue with that, that TARP banks could use the SBLF money to pay off TARP. That is Congress' call. What we are saying is, it was Treasury's call as to choose the right TARP banks to do that, and to also determine how much money they would give them. For example, they could choose the banks that would best lend, and it would have been obvious to them that if the banks did not have any additional capital to lend, that just giving them enough to pay TARP would not leverage into the multiples of loans, which is a basic premise.

Mr. CLAY. Well, your report says SIGTARP found that 42 TARP banks that received only enough SBLF funds to pay off TARP and lend out significantly less than they received in SBLF funds, increasing lending only by 25 cents for each dollar of these funds. Speaking of Missouri, give me some examples of banks. Can you name any Missouri banks?

Ms. ROMERO. Yes. In the 24 who decreased lending, there are two Missouri banks who decreased lending while in SBLF. Do you want me to name them?

Mr. CLAY. Yes, please.

Ms. ROMERO. Liberty Bancshares decreased lending by 20 percent. This is Small Business Lending. Fortune Financial Corporation, which decreased lending to small businesses by 13 percent while in SBLF.

Mr. CLAY. Wow. Okay. GAO surveyed banking institutions to learn why they had not applied for SBLF funding, and reported that a primary reason was a lack of interest in the program. A respondent's most common reason for not applying to the program was a lack of demand for small business loans. Do you disagree with GAO's findings?

Ms. ROMERO. I very much respect GAO and the other IGs. I don't disagree with the findings, but I think it is interesting because there should not have been any difference in loan demand based on whether you were a TARP bank or not. So to see 60 percent of TARP banks apply to SBLF and only 9 percent of the non-TARP banks, if there is not enough loan demand then there is not enough likely loan demand on the TARP banks, too. And that sends up a warning flag to me that some banks may have been looking at it as a TARP exit strategy.

Mr. CLAY. Thank you so much.

Ms. ROMERO. Thank you.

Mr. MCHENRY. I thank my colleague. And I recognize my colleague and neighbor from North Carolina, Mr. Meadows.

Mr. MEADOWS. Thank you, Mr. Chairman.

Ms. Romero, thank you so much for your illuminating and very detailed report. Thank you to your staff as well for being so well prepared.

As we start to see some of this come out, I appreciate your willingness and your thoroughness in trying to get the full picture. So many times what we do is we look at one segment of government and we say, okay, they are performing up to their standards, we look at another, they are performing up to their standards. But when we put them together, we find that the result, as in this case, is not something that helps small businesses at all.

I can tell you that my colleague opposite, talking about the GAO standards, saying there was not a demand for small business loans, as a small business owner for over 28 years, I can tell you there was never ever more of a demand or a need for that within the community banking system as was evident in this particular time. So I would certainly disagree with their assessment of this particular time.

You mentioned that roughly only 9 percent I think of community banks not in TARP applied for the SBLF funds. Isn't this in itself evidence that this was not an effective way to stimulate lending?

When we see it, it becomes more of a backdoor for TARP than it is for lending to small businesses.

Ms. ROMERO. Certainly for several TARP banks it was a way to get out of TARP, absolutely. Whether it is indicative of how they marketed the program, I don't really know how they marketed the program. This isn't something we looked into, because we were looking at the TARP banks. But it does raise a flag as to whether there was the right reach-out to get the right banks in the program.

Mr. MEADOWS. I think in your testimony you talk about the fact that you did exhaustive research, I believe, on 32 applications, SBLF applications. And from that, for almost all of them, I think 29 out of 32 applications, there was no evidence of any oversight or investigative nature on the part of Treasury to look at a detailed plan on how it would increase lending? Is that correct?

Ms. ROMERO. That is correct, and it actually goes broader than that. When we asked the questions and did interviews, and we looked at all the documents, we were told by the program director for SBLF that Treasury did no independent analysis to determine whether the lending in the lending plans was achievable, because they thought that was the bank regulators' jobs.

We found no independent analysis, so his statement was borne out by the documents. Then on top of that, we looked in detail at 32 and found that there was almost zero mention of the lending plans.

Mr. MEADOWS. Okay, so from a legislative standpoint, they were required to come up with a lending plan, but yet they didn't do it and we still gave them the money?

Ms. ROMERO. That is correct.

Mr. MEADOWS. In the private sector, would we call that fraud?

Ms. ROMERO. I don't know whether it is fraud here. I am also in charge of a criminal law enforcement agency, so that is not something we have looked at. But I would say it was very disturbing that there was this massive lost opportunity in determining which banks were the right banks to exit TARP and go into SBLF.

Mr. MEADOWS. So best case scenario, it was a gross mismanagement of oversight in terms of the implementation of this process?

Ms. ROMERO. It absolutely should have happened. There could have been three levels of review to make sure that these banks could have achieved the lending plan. It could have been at the subsidiary bank regulator, it could have been at the bank holding company regulator, which is the Federal Reserve, which actually, the bank holding company got the money, and it should have been at Treasury.

Mr. MEADOWS. I have just a little bit of time remaining, so you talk about 24 institutions that actually decreased lending.

Ms. ROMERO. That is correct.

Mr. MEADOWS. But at the same time, some of those institutions were paying better or higher bonuses and salaries and pay-outs to executives. Would you say that was systemic throughout or just isolated?

Ms. ROMERO. So, 14 paid dividends to their shareholders. That is a problem. That should never have happened.

Mr. MEADOWS. So instead of making loans to small businesses, they paid dividends to shareholders, instead of the money that they borrowed for that particular cost?

Ms. ROMERO. Absolutely. And not all those banks are public, but we looked and we saw at least two instances where they gave their CEO a raise.

Mr. MEADOWS. Lastly, is there any way that we can say, where we are today, Treasury, you can fix it? Do you see a willingness on their part to fix it going forward?

Ms. ROMERO. I am a glass half full kind of gal. I would like to see small businesses get the benefit, if we are going to have the tradeoff of getting these banks out of TARP, I would like to see small business increase. So we put our heads together to try to figure out how to do that, and said, why don't you work with the banks. It is not too late to try to get new small business lending in the future.

That is the prudent thing to do, it is not difficult to do. But Treasury rejected that.

Mr. MEADOWS. I thank the chairman for his patience, and I yield back.

Mr. MCHENRY. Ms. Duckworth of Illinois.

Ms. DUCKWORTH. Thank you, Mr. Chairman.

Ms. Romero, what I see here for me is a basic missed opportunity to get lending out to small businesses. Time and again, my small business owners in my district have said that lack of access to capital is one of the greatest challenges they face. And here we have a program that could get out as much as \$30 billion and we only use \$4 billion of it.

And the most fundamental point for me is a real lack of opportunity. It is opportunity wasted. I am really disappointed that Treasury did not accept the invitation to be here, and they could not be here today. I would have liked to hear both sides of the story.

From their letter to you to Don Graves, his response to some of your criticism was that the former TARP banks did report a medium small business lending increase of 18.4 percent, and that 84 percent of those banks that participated, former TARP banks that participated actually increased their small business lending, and 73 percent of those increased their small business lending by 10 percent or more.

You had said that one of the problems with this program is how Treasury chose how much money they would give banks, and that if they only gave banks just enough to cover their TARP repayment, that is what they went with. Do you think that perhaps part of the issue here is that the lending criteria was simply too rigorous, other than the other way around, which is what you suggest?

Ms. ROMERO. It is a really good question. It could go either way. If the banks really had no intention to lend and really had no additional source of capital to lend, then they shouldn't have been in the program at all. But for the ones who submitted the lending plan, there should have been more rigorous criteria, which is to really look at that.

And I appreciate the increases in lending that happen, because any increase in small business lending is helpful. But not all increases in small business lending have a meaningful impact. So remember, we are talking about banks that have very, very low lending levels. So even increasing it 10 percent, while it is helpful, it is not really a high bar. And that is why the goal of SBLF was not a 10 percent increase. That is just how you determine your cost of capital. The goal is a really basic principle of lending, that you take that money as capital and then you leverage off that loan in multiples. That is what we were looking for, and that is what we haven't seen happen.

Ms. DUCKWORTH. Thank you.

I would like to yield the remainder of my time to the ranking member.

Mr. CUMMINGS. Thank you very much. I thank the gentlelady for yielding.

I agree with Ms. Duckworth. I want to see every single small business get the money that they need. And there is a tremendous demand in my district. It is, we are handicapped in this hearing, because we have reputable people who seem to disagree with you. I wish we had them here, I really do. Because some of the accusations are quite strong. And everybody on both sides of the aisle knows that I am a great defender of people's reputations.

Did you ever have a chance to talk to Don Graves? Did you talk to him? He is in charge of the program.

Ms. ROMERO. Yes.

Mr. CUMMINGS. You did talk to him?

Ms. ROMERO. We coordinate with him, his office. We also coordinate with GAO and the Treasury Inspector General. I don't think anyone is in disagreement with what we are saying.

Mr. CUMMINGS. Well, let me just tell you, I am just looking at a letter, and this is why I am going to be pushing hard to get Treasury in here. Because again, we want to make sure our constituents benefit. When we have, well, let me read this. Mr. Graves said in his letter of March 28th, he says here "The report ignores," he is talking about your report, "ample evidence that Treasury conducted a serious review of applicants' lending plans. For example, of the banks and SIGTARP's sample that received SBLF funding, Treasury rejected as inadequate over 30 percent of the initial plans submitted by these institutions."

Now, as I sit here and I am listening, I didn't hear anything about that. What is going on there?

Ms. ROMERO. Sure. I am actually really glad you gave me an opportunity to talk about that. The serious review they did was to take the form that I included in my testimony and determine whether 12 elements were included in the plan. If something was missing, or if there was something that was deficient on their face, like they had to at least say they were going to lend out in the same amount of money they got in SBLF, if the amount was too low, Treasury would send it back.

That was their review. The banks would then just resubmit it with the information or change the number without any justification.

So there was a review, and I am not saying there wasn't a review. But what we are saying is it was superficial. What we were looking to see is, did you do an analysis or anything to determine whether the lending increases that they proposed in the plan was achievable. And we were told no by Treasury, we did not do any independent analysis because that was the regulators' jobs. And we were told by the regulators, no, we did not consistently do an analysis because that was Treasury's job. Our job was to look at safety and soundness.

There were a few instances where some of the bank regulators, particularly OCC, actually took a look at that. But like the FDIC, who regulated 69 percent of the TARP banks who applied, that wasn't their protocol. It wasn't their process. And they said Treasury knew we should be doing that.

So while Treasury did a review and rejected some things on a check-the-box basis because the box wasn't checked, they never did an independent analysis to determine whether the lending increases could actually be achieved. That is what these lending plans are for. When Congress put this safeguard in, they wanted to make sure that we wouldn't have a repeat of TARP, that the banks would actually lend the money out.

So Treasury's SBLF program director told us twice, we did no independent analysis, that was the regulators' job because the statute required the lending plan to go to the regulator, that was borne out by the documents, that was borne out by everything we saw. Then when we went and talked to the regulators and the regulators said that was Treasury's responsibility, that was borne out by the documents that the regulators gave us.

So what we are saying is, we are not saying there was no review. We are saying the review that happened wasn't a sufficient, adequate assessment to determine whether the banks had the wherewithal or could actually achieve the lending increases that they had proposed.

Mr. CUMMINGS. Thank you very much.

Mr. GOSAR. [Presiding] Thank you.

I am going to recognize myself for five minutes.

Ms. Romero, with this checklist for the banks be similar to what scrutiny businesses would go through for a lending program?

Ms. ROMERO. No, and it should be.

Mr. GOSAR. Not even close, is it?

Ms. ROMERO. It shouldn't be how the government makes its investments.

Mr. GOSAR. Wow. Would you consider \$1.13 cents return versus \$1 investment a good portfolio?

Ms. ROMERO. No, and I wouldn't consider taking \$500 million and then not lending off of it a good portfolio, either.

Mr. GOSAR. It is pathetic. I am a businessman, and I happened to be a dentist for 25 years, so the return on investment is pathetic.

Mr. Geithner, when the Secretary talked to Congress in regard to this program, did he misrepresent this program to Congress? Specifically in that clip, he talks about a return on investment of lending of \$8 to \$10 for every dollar invested. That is clearly not what transpired here.

Ms. ROMERO. I think the intention was there. I think the problem was in the execution.

Mr. GOSAR. So let me get this straight. Thank you. So execution really poor again. It seems we have a recurrent theme here with the Secretary of Treasury that we have very poor oversight. Maybe we mean well, but we have very poor exercise of the facts. Is it not financial aspects are about facts and about details, is it not, Ms. Romero?

Ms. ROMERO. The facts and the details are incredibly important here.

Mr. GOSAR. Secretary of Treasury and we can't get those right.

Let me ask you what is fair. If a bank made a dividend purchase, do you think it is fair that the taxpayer should get it back? And how about the CEOs, getting those paid? Shouldn't we get that back? That should be fair, right?

Ms. ROMERO. I absolutely agree with that. That never should have been allowed. It should not be allowed in the future. We have made a recommendation to the banking regulators to never allow it again and they have rejected that recommendation.

Mr. GOSAR. Wow. So the ranking member just talked to you about a letter from Mr. Graves about a rigorous, serious review of these protocols. That checklist to me is hardly a serious review. It seems like we go over and over again pointing the finger, the blame game, so that we don't know who is responsible for this. But it really lies with Treasury, does it not?

Ms. ROMERO. It is their program.

Mr. GOSAR. I know you went in depth a little bit with Mr. Graves' letter with the ranking member. But for moms and pops out there, that is real ill-intentioned, right?

Ms. ROMERO. Treasury is absolutely responsible in picking the right banks to go in. And when Congress says, well, we don't want a repeat of what happened with TARP, we are lending an increase, we are going to fix it, and our safeguard to make sure that they lend is to require a lending plan, when there is no meaningful, consistent review of that lending plan by the government, then the intent of Congress is thwarted in putting that safeguard in.

Mr. GOSAR. I am glad you brought that up, the intent of Congress. Do you believe that this bill was well-vetted?

Ms. ROMERO. I don't have any idea on how Congress did that.

Mr. GOSAR. It seems to me that this was very ill-vetted, because the application you always look at outcomes. What was the intended course and the outcomes. This is a failure by any stamp of the imagination. And we didn't vet this bill very appropriately. This was rushed through in Congress. We actually had a Secretary of Treasury misrepresenting the plan, at least giving it expectations that there was no intentions of follow-through. Because what I see the Secretary of Treasury doing is explaining one thing to Congress and then following through with nothing, absolutely nothing.

Wait a minute. You made a comment that said that the numbers match the TARP numbers, did you not? So there must have been very interesting dialogue behind the scenes, right?

Ms. ROMERO. The 42 banks only got enough SBLF dollars to pay off TARP. It should have been obvious that the banks then did not

have capital to lend off of. And beyond being obvious, we sent a letter to Secretary Geithner September 2010, when they were picking the banks, warning of this, and saying, you can't switch a bank out of TARP into SBLF, it doesn't make sense, if they don't have the capital to lend but for the TARP capital. And that was rejected.

Mr. GOSAR. The fox in the henhouse, just really interesting.

Just one last question, I know I am running out of time. Do you feel there is adequate capital for small business out in America right now?

Ms. ROMERO. No.

Mr. GOSAR. What is our number one biggest area of growth? Is it large business or small business?

Ms. ROMERO. Certainly I agree with Congressman Duckworth, small businesses really need help here. That is why we made the recommendation to try to help, that Treasury should even now try to help these banks come up with a new plan to increase lending to small businesses. That is what we are looking at, we are looking at it from the small business perspective.

Mr. GOSAR. Thank you very much, Ms. Romero. I would like to acknowledge the gentleman from Nevada, Mr. Horsford, for five minutes.

Mr. HORSFORD. Thank you very much, Mr. Chairman. And thank you, Ms. Romero, for being here today.

I have said before that I am not a defender of every Federal program. I am a defender of my constituents who rely on Federal programs to meet the needs in our respective communities. And when I talk to my small businesses, their number one issue is access to capital. So it is incredibly frustrating when we hear about these programs and the very entities that are responsible for them aren't present to talk about them. I want to say for the record I find that inappropriate.

I also feel that we need more input from the very people that these programs are supposed to benefit. I would love to hear from small businesses who both got loans or didn't get loans. I would love to hear from some of the community banks. Many in my district, it was the community banks that were trying and are trying to work with small business in my area, more so than some of the larger banks that don't even return people's calls.

So Ms. Romero, my question is, the fact that the Small Business Lending Fund program is different than TARP, that it is an incentive-based investment program, correct?

Ms. ROMERO. Yes.

Mr. HORSFORD. So under statute, Congress directed that funds be made available to community banks and other small financial institutions, including former TARP recipients, with an incentive for participants to increase small business lending, right?

Ms. ROMERO. Yes.

Mr. HORSFORD. So the bottom line is that more banks, that the more banks increase their loans to small businesses, the less they pay in dividends. And if recipients fail to increase their small business lending over time, that the price of those dividends goes up as well?

Ms. ROMERO. The best way to do it for the TARP banks is to do a comparison to what they would pay in TARP to what they pay

in SBLF. If they don't increase at all, there is no penalty to the SBLF banks. They pay the exact same that they would in TARP. So they get to escape all of the TARP restrictions on executive compensation, luxury expenditures, that sort of thing, and they just pay the same amount.

If they increase their lending by a dollar, they are going to pay less in a dividend than they would in TARP.

Mr. HORSFORD. So that is the basic way in which the program is structured?

Ms. ROMERO. Yes.

Mr. HORSFORD. So there is an indication, though, in your report on April 9th that you raised a concern about this process, stating "If the former TARP banks fail to increase lending, there is no meaningful penalty." Was that your statement?

Ms. ROMERO. Absolutely. That is what I just explained. Because they get all the benefits of leaving TARP but there is no penalty on them. So for the 24 banks that decreased their lending, nothing is happening with them. No one is standing up other than SIGTARP and saying, this should not be allowed in the program. And they are paying the same amount that they would under TARP. So there is no penalty for them to decrease their lending.

Mr. HORSFORD. And if banks don't pay back the taxpayer in a timely manner, the taxpayer return could be even more substantial, is that correct?

Ms. ROMERO. Yes, and you have to look at if those banks had stayed in TARP, then if some of these banks, not just these 24, but if we look at some of them that only lent an incremental amount and got a dividend break, if they had stayed in TARP they would have paid more to taxpayers in their dividends. So what we are saying is, we will take any increase in lending to small businesses, not every increase has a real meaningful impact on the small businesses that you talked about.

Mr. HORSFORD. I agree, and I think that ultimately, that is what I want to get to, when I look at this chart that was provided to us. The West, the State that I represent, Nevada, was second to last in small business lending in the region of the Country. So I want to know why businesses in my area didn't get the same opportunities to loans, and if that was due to failure on the part of Treasury, on the implementation of this program. I expect them to be able to answer my questions as a member of Congress, so that I can go back and tell my businesses this is how this program works. And if you qualify, pursue it. Because people need what they are offering, which is access to capital.

Thank you very much, Mr. Chairman.

Ms. ROMERO. I agree.

Chairman ISSA. [Presiding] Thank you, and thank you for your insightful questions.

Very briefly, I want to make the record straight from the standpoint of a couple of things. First of all, this program has now ended. So we are in the payback phase of no net new money. So if I understand from a corrective action, we really can't pull back the money and redistribute it at this point or force higher lending, is that correct?

Ms. ROMERO. That is correct. But I think Treasury should still try to work as hard as they can to try to increase lending. Not through money.

Chairman ISSA. I appreciate that. One of the impressions I got through this hearing was that the President was not well served in the implementation. I think on both sides of the dais you saw that. Certainly 42 banks simply rotated from being covered under stringent rules, bipartisan rules of accountability and pay and luxury benefits. And they got out of it. They borrowed enough to pay off their loan, so they didn't care. They just wanted one source of money replacing another. And it was pretty transparent, when you borrow exactly what you need to get out of TARP, right?

Ms. ROMERO. Right. And some of them paid less of a dividend than they would in TARP.

Chairman ISSA. So we lost money through this maneuver.

Ms. ROMERO. On those banks, yes.

Chairman ISSA. Now, if I have my figures correct, this program was a \$30 billion program, sizeable program.

Ms. ROMERO. Yes.

Chairman ISSA. And \$4 billion actually went out, is that correct?

Ms. ROMERO. Yes.

Chairman ISSA. And \$2.1 billion went to these basically TARP banks that had little or no return.

Ms. ROMERO. Yes, \$2.1 billion went to pay off TARP.

Chairman ISSA. Went to pay off TARP. So the real tragedy here is one, the money wasn't used nearly to the level authorized; two, it went roughly half to paying off TARP. I might remind all of us that \$2.1 billion is not a lot of money into TARP, so it is a relatively small group of banks that got the benefit compared to the total dollars of TARP.

The lesson learned that I want to ask, and I will send this over to Financial Services hopefully in a joint report, is, if I hear you correctly from your report, one, we need to insist that the term plan be more than a one page check off the box. We need to find a way to do that in the legislative language and guidance.

Two, when we authorize \$30 billion, there has to be some expectations of reasonable goals, achievement, because this \$30 billion, and the gentleman from Nevada made a good point, that \$30 billion, if another \$26 billion of it had gotten out there, it would have made a huge difference at even a three times multiple as to the availability of funds to small business.

Lastly, as far as I can tell, we should have had strings on TARP banks, now, that may never happen again. But we could say any bank which had an alternate government loan, from simply paying off one loan with another loan. That should have been explicitly net new capital, otherwise there could be no expectation that actual net loans would change.

Ms. ROMERO. Absolutely. I would agree with all of that.

Chairman ISSA. And I guess the one more thing I got out of the hearing today is defined point of accountability. The language of the legislation was pretty clear. But it was certainly possible for Treasury to say as they said to you, we thought the regulators would do it, while regulators said, we had no specific guidance, and they shirked, if you will, proactive responsibility.

Did I cover the points here today?

Ms. ROMERO. Absolutely.

Chairman ISSA. I am going to yield to the ranking member for his closing. But I think what you have been helpful for here, which is unusual, is this is not a big scandal. There is no criminal activity. But there is a series of lessons learned for legislative language that you cannot oversight and you cannot delegate and hope for the best in the areas I just outlined. Would that pretty much summarize what you would like us to take away from today's hearing?

Ms. ROMERO. Absolutely. Although I also think that the fault doesn't all lie with the language in the statute. I think when there is an intention in the statute and when there are statements being made to Congress about the intent, that needs to be followed through, and the agencies who are responsible need to take responsibility for that. There needs to be accountability. What we said is there needs to be better coordination and communication.

We have with TARP, we have with SBLF, and we have with a number of things going forward after the crisis a government that doesn't want to be stovepiped or siloed, they want to work together. What we are saying is, when you work together, improve your coordination and your accountability and improve your communication. That recommendation was denied. And we don't see how that can be denied, and it shouldn't be denied.

Chairman ISSA. I guess I will put in a small pitch in closing for the Data Act, something that has been passed out of this committee previously and something that would provide real-time transparency to oversight, both in the Administration and obviously it would have allowed Congress to be aware of these figures sooner, and the Inspector General's office, I might add.

So that will all end up in our report. Mr. Cummings, do you have a closing statement?

Mr. CUMMINGS. Thank you very much.

First of all, Mr. Chairman, I want to associate myself with what you just said. It is very frustrating for my constituents, about a year or so ago we had a forum in my district with the Federal Reserve for small business people, probably about a year and a half ago. All these small businesses came out. Their number one concern was access to capital. They had been doing well.

The interesting thing is that a number of them said, look, we have opportunities, but we can't get the funds to do the job. We can't even get line of credit. And then to hear a program that has certain intended results not get those results is sad.

Treasury says that the reason why they could not be here is they only had eight days notice. I really would have liked to have heard from them. But one thing that needs to go forth from this hearing is that we can do better. And that is what you are saying.

Ms. ROMERO. Yes.

Mr. CUMMINGS. Sometimes I think, Ms. Romero, we get caught up, and I have seen this in government in various ways, in a culture of mediocrity. Certain agencies get to a point where they could do better, but for some reason they don't. So I guess when you have, and this is what I want your answer on, so you think the law, the way it was drawn up, the law itself, could have been clearer, or you just think that it was clear enough and there was just

some disregard or both, disregard of doing what was necessary to get the full intended results? Do you follow my question?

Ms. ROMERO. Yes, absolutely. Congress' intent is clear in this statute.

Mr. CUMMINGS. So it is not the statute?

Ms. ROMERO. I think this is the point I was trying to make, there is a lending plan that is a safeguard. But you have to take responsibility when you are Treasury or the banking regulators who are looking at that lending plan to make sure that Congress' intent is met.

I think what the chairman was saying was, if they can't take accountability to do that, then maybe Congress has to lay it out more clearly. But they shouldn't have to. Congress shouldn't have to. Treasury and the regulators have to take accountability. When we look at our work, I know some people think that an IG's job is to criticize, but that is not what we do. We are trying to make these programs better. We are trying to get help to people who need help from TARP, small businesses that needed help from these programs. We are trying to say, if you took a bank out of TARP that would pay less in dividends to taxpayers, that tradeoff is fine and good if there is a meaningful impact on small businesses and they get the benefit of that.

So all we are trying to do is say, how do we get there? Let's remove the obstacles that didn't allow us to get there in the first place, and let's move forward. When Treasury takes a defensive posture and just defends what they did and doesn't talk about what they should have done or still can do, it is not really an effective response to an Inspector General's report. Unfortunately, that is typically what has been happening with our reports.

We are trying to work together with them, to make sure that the intent of Congress is met. We are not trying to criticize for criticism's sake. We are trying to make this better. That is what is frustrating.

Mr. CUMMINGS. I have to tell you, since I have been in Congress, over 16 years, that is one of the best statements I have ever heard, what you just said. I really mean that. Because you are right, that is what it is all about, how do you make sure that things are done in an effective and efficient manner. It is simple.

I tell folks all the time, it is so important to me that government functions properly. My constituents need government to function like government is supposed to function. The statement you just made about the role of the IG, I totally agree with you. Hopefully, Treasury is listening to this and for future times maybe we will have a better situation.

Thank you very much, and we thank your entire staff.

Ms. ROMERO. Thank you so much.

Chairman ISSA. I want to thank again all of you for your service and for being witnesses here today. We stand adjourned.

[Whereupon, at 11:00 a.m., the committee was adjourned.]



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

March 28, 2013

Christy L. Romero
Special Inspector General
for the Troubled Asset Relief Program
United States Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

RE: Response to SIGTARP's Draft Audit Report: "Banks that Used the Small Business Lending Fund to Exit TARP"

Dear Ms. Romero:

Thank you for the opportunity to review the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) draft report on banks that refinanced Troubled Asset Relief Program (TARP) investments in the Small Business Lending Fund (SBLF). As you know, SBLF is not a TARP program. Nonetheless, the Department of the Treasury (Treasury) appreciates your interest in the program as it relates to former TARP institutions. This letter provides Treasury's official response.

I. Former TARP Banks have Significantly Increased Small Business Lending in SBLF

The SBLF program has been a success. In the five quarters following funding, SBLF institutions have made significant progress in increasing small business lending. As of December 2012, SBLF participants have increased their small business lending by \$8.9 billion, with a median increase of 29 percent. These increases are widespread. Ninety percent of all participants have increased their small business lending. Further, a substantial majority of participants—more than 83 percent—have increased their small business lending by 10 percent or more. This lending has been widely distributed across the country and among loan sizes and types.¹

Former TARP banks are no exception. When compared with banks that did not participate in SBLF, former TARP banks report an increase in total business lending over three times greater than that of their direct peers, and over six times greater than the increase reported by community banks. We disagree with the Report's finding that these banks have not effectively increased small business lending; the program's results to date directly contradict that conclusion. For example:

¹ *SBLF April 2013 Use of Funds Report: Report Submitted pursuant to Section 4106(3) of the Small Business Jobs Act of 2010*, to be submitted to Congress in April 2013.

- Former TARP banks have increased their small business lending by \$3.6 billion over baseline levels. This increase is more than 40 percent of the total increase reported by all SBLF participants.
- Former TARP banks report a median small business lending increase of 18.4 percent – well above the 10 percent increase that Congress established as the threshold level for earning the maximum incentive under the program.
- 84 percent of former TARP banks have increased their small business lending, and 73 percent have increased small business lending by 10 percent or more.

Indeed, former TARP banks considered as a group have far exceeded the benchmarks Congress set for SBLF. To achieve the maximum dividend rate reduction offered by Congress, these banks would have needed to increase small business lending by a total of \$2.9 billion over two years. After only one year, former TARP banks have already increased their lending by more than this amount. In addition, these banks are ahead of schedule in achieving the increases specified in their lending plans. Just over halfway through the two-year window that Congress established for banks to increase lending, former TARP banks have already achieved a median 95 percent of the lending increases projected in their plans. Forty-seven percent of these banks have exceeded their plans' full two-year targets.

SIGTARP's conclusion that these institutions have not effectively increased lending is based solely on a comparison between former TARP institutions and other non-TARP participants in the program. This comparison is flawed for a number of reasons. First, non-TARP banks received significant additional capital under SBLF, while former TARP participants were required to refinance their outstanding TARP capital and therefore received minimal or no net new investment through SBLF. As expected, banks that received more additional capital under SBLF report greater lending increases than banks that received less. TARP banks also used their initial TARP investments to increase their business lending before entering SBLF, with a median increase of six percent prior to the baseline period. These pre-SBLF lending increases raised the baseline against which lending growth is measured in SBLF. Consequently, these banks entered SBLF with a higher bar against which they are measured than their non-TARP counterparts. And again, the fact remains that former TARP banks as a group have significantly increased small business lending and have exceeded all Congressional benchmarks for the program.

II. Oversight of the SBLF Program has been Extensive

The SBLF program is subject to a tremendous amount of oversight. The law that created SBLF provided for oversight by two entities, the Treasury's Office of the Inspector General (OIG) and the Government Accountability Office (GAO). The OIG has a statutorily prescribed Special Deputy Inspector General for SBLF oversight who has issued half a dozen reports on the program since early 2011. The GAO has also reviewed SBLF, publishing detailed evaluations of the program in 2011 and 2012. Treasury has accepted all of OIG's 19 recommendations, and has accepted all three recommendations from GAO. Both OIG and GAO will continue their strong oversight of SBLF as the program moves forward.

These oversight bodies have offered thoughtful critiques of SBLF that have served to strengthen the program. They have also issued positive findings that stand in contrast to SIGTARP's portrayal of the SBLF application review process and the program's overall success. OIG, for example, concluded that Treasury's later-entry application review process was sound, finding that Treasury "consistently approved institutions that would likely meet their financial obligations to the SBLF program."² OIG also found that "institutions not admitted into the program received adequate consideration," and "applicants . . . received reconsideration based on consistent criteria."³ Similarly, GAO found that "Treasury adopted procedures to help ensure that applicants were evaluated consistently and were likely to repay funds . . ."⁴ GAO also found that banks participating in SBLF have increased lending, concluding that these banks have "noticeably higher changes in lending rates" when compared to similar non-SBLF institutions.⁵ The Report does not acknowledge these aspects of SBLF, resulting in an unbalanced view of the program.

III. Congress Required Treasury to Allow TARP Bank Participation in SBLF

The Report criticizes Treasury because "[n]any TARP banks primarily looked at SBLF as an opportunity to exit TARP, escape TARP's restrictions, and pay less for taxpayer money." However, Congress explicitly instructed Treasury to permit the refinancing of TARP funding through SBLF. The Small Business Jobs Act of 2010 — which created SBLF — provides:

The Secretary shall . . . issue regulations and other guidance to permit eligible institutions to refinance securities issued to Treasury under [TARP programs] for securities to be issued under the Program.

Treasury had no discretion in this matter. While SIGTARP may believe that SBLF should not have been available to TARP banks, the fact is the law required it.

In executing Congress's directive, Treasury took great care to preserve program incentives to promote small business lending among former TARP banks. For example, Treasury instituted a two percent lending incentive fee to prevent TARP banks from receiving a dividend rate benefit solely by virtue of their participation in SBLF. Thus, for the small number of former TARP banks that have not increased small business lending, those banks have not paid a dollar less to the taxpayer than they otherwise would have under TARP. Only those former TARP banks that increase their small business lending are charged a lower dividend rate under SBLF. And the program results speak for themselves. Rather than languishing in SBLF after an "escape" from the burdens of TARP, as the Report suggests, the vast majority of former TARP banks have benefited small businesses through substantial increases in their small business lending.

² OIG, *Soundness of Investment Decisions Regarding Later-Entry, Withdrawn and Reconsidered Institutions in the SBLF Program*, OIG-SBLF-12-004 (July 3, 2012).

³ *Id.*

⁴ GAO, *Small Business Lending Fund: Additional Actions Needed to Improve Transparency and Accountability*, GAO-12-183 (Dec. 2011).

⁵ GAO, *Small Business Lending: Opportunities Exist to Improve Performance Reporting of Treasury Programs*, GAO-13-76 (Dec. 2012).

In addition, Treasury declined to approve over half of all TARP applications to SBLF, which is comparable to the percentage of non-TARP banks denied funding. Contrary to the Report's implication, TARP banks received robust scrutiny throughout the SBLF application review process.

IV. SBLF's Dividend Rate Structure Incentivizes Small Business Lending

The Report gives short shrift to the dividend rate incentive structure at the core of the SBLF program. It is simply untrue that without the "safeguard" of "meaningful" lending plan review SBLF banks will be unmotivated to increase their small business lending. Congress established specific incentives for banks to increase lending and disincentives for banks that fail to increase lending. Banks receive a dividend rate benefit only if they show actual increases in their small business lending. Banks that fail to increase lending pay a higher rate, at a level that is expected to earn a profit for the taxpayer. These incentives are not linked to the banks' lending plans. In fact, Congress did not even require banks to project increases in small business lending in their lending plans. Treasury and the banking regulators added this component.

In addition, the Report ignores ample evidence that Treasury conducted a serious review of applicants' lending plans. For example, of the banks in SIGTARP's sample that received SBLF funding, Treasury rejected as inadequate over 30 percent of the initial plans submitted by these institutions. Banks then had to resubmit satisfactory plans to receive approval for funding.

V. The Report Contains Numerous Errors and Omissions

There are numerous other errors and omissions in the Report. For example, we disagree that Treasury and the Federal banking regulators did not effectively communicate with each other throughout the SBLF application review process. Treasury and the banking agencies engaged in extensive collaboration before and during the investment process, documented their mutual agreement regarding the supervisory consultation process, and were well apprised of the scope of each party's review. Treasury's own review process was designed in a manner consistent with this shared understanding and was not based upon a "lack of coordination" as the Report contends. SIGTARP apparently relies on misquotes or out-of-context statements from SBLF's program director to argue that there was a miscommunication. Treasury provided comments to SIGTARP clarifying that the Report's citations were inaccurate and did not reflect our understanding of the process, but SIGTARP appears to have ignored these comments. The Report also fails to acknowledge the substantial written record of coordination between Treasury and the regulators regarding the lending plan review process.

Another significant error is that SIGTARP states that there were "obvious deficiencies" in some lending plans that Treasury "should have caught." The Report implies that Treasury approved some of these plans despite the deficiencies, when in fact the applicants were denied funding based on their financial condition. These institutions were not asked to resubmit lending plans because their applications would not have been funded in any event. In other instances, the banks had revised their plans to remedy the issues the Report cites prior to receiving approval. In addition, SIGTARP states that 29 of the 32 TARP bank applications sampled "showed no

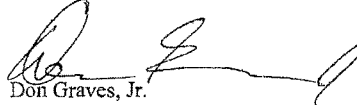
documented Treasury review of the banks' lending plans." However, each application file for those banks included a lending plan evaluation completed by Treasury staff.

VI. Recommendations

Regarding the Report's first recommendation, we believe that Treasury's coordination with regulators throughout the SBLF application review process was extensive and complete. Treasury entered into formal agreements with the regulators defining each entity's role in the process, and also documented procedures through flowcharts, risk management tools, and reporting systems. Together with weekly meetings, these tools resulted in effective communication among all entities throughout the investment process. As for SIGTARP's second recommendation, as noted above, Congress designed SBLF to incentivize small business lending through the program's dividend rate structure. Treasury will continue to rely on that structure to incentivize lending increases going forward. Finally, Treasury has no response to SIGTARP's third recommendation, which appears to be directed to federal banking regulators, not Treasury.

Thank you once again for the opportunity to review and comment on the Report. We appreciate SIGTARP's work over the course of this audit.

Sincerely,

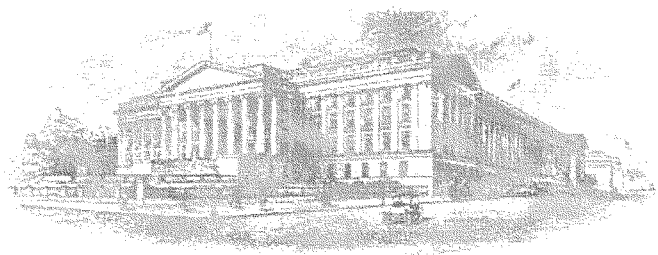


Don Graves, Jr.
Deputy Assistant Secretary

cc: Debra Ritt
Special Deputy Inspector General for
Office of SBLF Program Oversight



Audit Report



Report Number: OIG-SBLF-12-004

SMALL BUSINESS LENDING FUND: Soundness of Investment
Decisions Regarding Later-Entry, Withdrawn and Reconsidered
Institutions in the SBLF Program

July 3, 2012

Office of
Inspector General

Department of the Treasury

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Abbreviations	
ARC	Application Review Committee
FBA	Federal Banking Agency
FDIC	Federal Deposit Insurance Corporation
FRB	Federal Reserve Board
IC	Investment Committee
OIG	Office of Inspector General
OCC	Office of the Comptroller of the Currency
SBLF	Small Business Lending Fund



The Department of the Treasury
Office of Inspector General

Audit Report

July 3, 2012

Don Graves, Jr.
 Deputy Assistant Secretary for Small Business, Housing, and Community
 Development

This report presents the results of our audit of investment decisions involving the Small Business Lending Fund (SBLF). SBLF is a fund created to provide capital to community banks with assets of less than \$10 billion with incentives to stimulate small business lending. Our audit objectives were to determine whether Treasury: (1) consistently approved institutions that were financially viable and able to repay the SBLF investments; (2) gave adequate consideration to institutions that were not approved and asked to withdraw their applications; and (3) had adequate bases for denying funding to institutions.

To accomplish our first objective, we reviewed investment decision records for 47 randomly sampled institutions that Treasury approved and funded within the last 60 days preceding the program's September 27, 2011, funding deadline. We compared supervisory consultative memoranda from the institutions' regulators—the Federal Deposit Insurance Corporation (FDIC) and Office of the Comptroller of the Currency (OCC)—to the most relevant bank examination reports prepared by FDIC and OCC to determine whether they provided Treasury with robust and complete information regarding the financial health of the institutions. We also attempted to review a sample of institutions regulated by the Federal Reserve Board (FRB), but the FRB declined to provide us with reports of examination until after our audit was completed, creating a scope limitation for the first objective of this audit.

To accomplish our second objective, we reviewed documents supporting Treasury's investment decisions for a judgmental sample of 34 institutions that Treasury identified as being "reconsidered" for SBLF funding. We also reviewed updated financial and regulatory information recorded by Treasury subsequent to its initial review of the reconsidered institutions, and verified that Treasury was not informed of changes that had occurred in the financial condition of institutions that were not reconsidered. We interviewed SBLF staff, and officials from FDIC, and OCC. Finally, to accomplish our third objective, we reviewed investment

decisions for a sample of 51 institutions that Treasury asked to withdraw from the program between June and September 2011.

We conducted our fieldwork from October 2011 to May 2012 in accordance with *Government Auditing Standards*. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. Accordingly, we believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Appendix 1 contains a more detailed description of our audit objectives, scope, and methodology.

Results in Brief

Based on our review of 47 FDIC- and OCC-regulated banks, we found that Treasury consistently approved institutions that would likely meet their financial obligations to the SBLF program. However, we identified four institutions that had repayment probabilities below the 80-percent threshold for program acceptance. For three of the institutions Treasury documented compensating factors supporting its funding decisions. However, Treasury did not have an adequate basis for elevating the repayment probability of the fourth institution. Similar to our previous audit, bank examination reports from the Federal Banking Agencies (FBAs) for these institutions flagged supervisory concerns beyond those disclosed to Treasury in supervisory consultative memoranda. Treasury was aware of these concerns for all but one of the admitted institutions, primarily because Treasury's documentation of its decisions improved.

We also found that institutions not admitted into the program received adequate consideration before Treasury asked them to withdraw their applications. In all 34 cases reviewed, Treasury requested updated supervisory information, financial data, and/or the status of regulator-imposed dividend restrictions before deciding to approve or deny the applications. The applicants also received reconsideration based on consistent criteria.

Finally, our review of 51 institutions denied funding disclosed that 32 did not meet the basic eligibility requirements, and therefore could not be admitted. The remaining 19 institutions were reviewed by Treasury's Application Review Committee (ARC) or Investment Committee (IC) and denied funding based on clear risks the committees identified with the financial health of the banks and/or their lending practices.

Background

On September 27, 2010, President Obama signed into law the Small Business Jobs Act of 2010, establishing the SBLF. SBLF is a fund created to provide capital to community banks with incentives to stimulate small business lending and, as a result, promote job creation and economic growth within communities. In addition to statutory eligibility requirements, participation in the SBLF program was restricted to financially viable institutions that were (1) adequately capitalized, (2) not expected to become undercapitalized, and (3) not expected to be placed into conservatorship or receivership.

Treasury launched the SBLF program in December 20, 2010, and by the June 22, 2011 application deadline, had received requests from 935 financial institutions for \$11.8 billion of the \$30 billion authorized for the program. Treasury disbursed approximately \$2.3 billion of the funds in the last 60 days leading up to the September 2011 deadline. By the program's September 27, 2011 funding deadline, Treasury issued preliminary approvals to 400 institutions, with 332 institutions accepting a total of \$4.03 billion. Of the remaining 535 applicants, 461 were not admitted, and 74 withdrew prior to Treasury's consideration.

In May 2011, we reported that Treasury established an 8-step investment decision process that examined applicant eligibility, financial viability, and ability to repay Treasury's SBLF investment.¹ While we determined that the process was consistent with legislative eligibility requirements, we also identified areas for improvement. Specifically, we reported that Treasury did not require thorough disclosure from the FBAs of supervisory issues influencing the health of the banks and had granted FBAs significant discretion over the types of information they could report to Treasury. However, Treasury personnel did not agree to specify the types of supervisory issues that FBAs should report, because doing so would have reopened what had already been lengthy negotiations with the regulators.

In February 2012, we reviewed 23 of the first 55 applicants accepted into the SBLF program.² We reported that Treasury approved institutions that may have difficulty meeting repayment and dividend obligations partly because it did not obtain sufficiently robust information from federal regulators about the condition of the institutions applying for

¹ OIG-SBLF-11-001, *Small Business Lending Fund: Investment Decision Process for the Small Business Lending Fund*, May 13, 2011.

² OIG-SBLF-12-002, *Small Business Lending Fund: Soundness of Investment Decisions Regarding Early-Entry Applicants into the SBLF Program*, February 17, 2012.

funding. However, Treasury also admitted institutions despite supervisory issues and investment staff concerns about applicant repayment ability. This occurred because Treasury gave federal regulators discretion over what information they reported, did not document their consideration of the supervisory concerns provided, and overrode requirements during the application review process.

Treasury Generally Approved Institutions that Could Likely Meet Their Financial Obligations to the SBLF Program

Our review of supervisory and financial information for 47 FDIC- and OCC-regulated institutions admitted to the SBLF program disclosed that they were generally viable and likely to meet dividend and repayment obligations. However, we identified four institutions that were admitted to the program with repayment probabilities of less than 80 percent—the program threshold for acceptance. Treasury adequately supported its approval of three of these institutions by compensating factors justifying the investment decisions, but did not adequately support its approval of the fourth institution. We also found that Treasury had sufficiently robust information from the FBAs about the financial health of the institutions and that it performed a thorough analysis of those admitted.

Treasury Admitted Some Institutions with Potential Repayment Issues

We identified four institutions, including one TARP recipient, that were accepted into SBLF with repayment probabilities below the threshold set for the program. Treasury established an 80-percent repayment probability threshold for participation. Despite this threshold, it approved one institution whose repayment probabilities were 70 percent and three that were 76 percent. For three of the institutions, including the one TARP recipient, Treasury documented in ARC or IC minutes the reasons for revising the credit analyst's assessment including:

- The first institution's classified assets were \$6 million or 40 percent lower than the additional loan losses projected by the credit analyst, resulting in an improved forward Tier 1 ratio and a revised repayment probability above 80 percent;
- The second institution's earnings were projected to be \$2 million more than the credit analyst's projection, based on current earnings. The higher projected earnings would improve the institution's Tier 1 capital ratio, resulting in a revised repayment probability of 80 percent;

- The credit analyst's projected loan losses of \$37 million were approximately 30 percent higher than the third institution's classified assets of \$24 million. In addition, the ARC noted that the institution had no other debt, its allowance for loan and lease losses was adequately funded, and the quality of the institution's assets had improved.

In each case, Treasury documented its deliberations and the factors that led to its repayment recalculations in the minutes associated with the institutions. Although we do not know whether these institutions will be able to pay dividends and repay the SBLF investments, Treasury's analyses are transparent in the minutes.

However, Treasury did not appear to have an adequate basis for raising one de novo institution's repayment probability level. Because this institution had no classified assets, Treasury reduced the classified assets and provisioning below those used in the credit analysis. Treasury also determined that, based on supervisory information, the credit analyst's evaluation of the institution's qualitative factors was overly negative. If adjusted for these factors, Treasury determined the loan losses would result in a Tier 1 common ratio of 8 percent and a repayment probability above 80 percent. Because this institution was a de novo bank, for which asset quality typically starts high until the portfolio matures and experiences more defaults, we believe Treasury should not have adjusted the institution's projected potential loan losses and forward Tier 1 common ratio based on the absence of classified assets.

Treasury Admitted Banks with Identified Issues with Asset Quality, Earnings, Capital, and Management

We found that 35 of the 47 approved institutions sampled had noted supervisory concerns. FDIC and OCC bank examination reports and supervisory consultative memoranda, CAMELS³ ratings, and/or communications with Treasury mentioned concerns about these institutions' earnings, asset quality, capital, and/or bank management.

³ "CAMELS" refers to ratings of six essential components of an institution's financial condition and operations that FBAs assign to financial institutions. These component factors address: adequacy of capital; quality of assets; capability of management; quality and level of earnings; adequacy of liquidity; and sensitivity of the institution's earnings or capital to market risk. FBAs assign composite and component ratings of 1 to 5, with 1 indicating the strongest performance and least degree of supervisory concern; and a 5 indicating the weakest performance, and highest degree of supervisory concern.

TARP banks had roughly as many supervisory concerns as did the other banks admitted to the program. Of the 47 banks sampled, 28 were former

TARP recipients that refinanced their TARP investments through SBLF. As shown in Table 1 below, 21 of 28, or 75 percent, of the TARP banks in our sample had supervisory issues compared to 14 of 19, or 74 percent, for non-TARP banks. However, TARP banks had a higher percentage of supervisory issues in more than one category. For example, 11 of 21 (52 percent) of the TARP banks sampled with supervisory issues had two or more categories of concerns compared to 5 of 14 (36 percent) of the non-TARP banks.

Table 1: Numbers of TARP and Non-TARP Institutions with Supervisory Issues

	Asset Quality Issues Only	Earnings Issues Only	Issues In Two or More CAMELS Components	Total
Institutions Refinancing TARP Funds	6	4	11	21
All Other Accepted Institutions	5	4	5	14
Total	11	8	16	35

Reports by FBAs and the Treasury Office of Inspector General (OIG) have shown that these characteristics can contribute substantially to the financial decline of banks. Even if such issues do not affect a bank's viability, they may impair a bank's ability to consistently pay dividends or repay Treasury's investment.

Based on our review of the consultation memoranda and the ARC and IC minutes, we believe that Treasury was aware of the supervisory concerns we identified for all but one of the institutions admitted, and had documented mitigating factors for its decisions. Treasury also informed us that it never intended to restrict the program to institutions without supervisory issues. For example, Treasury approved one institution for the program after asset quality and earnings improved in the second quarter. Treasury admitted a second institution that it initially recommended for withdrawal based on weak earnings, asset quality, and a less-than-satisfactory management rating after second quarter financials showed that asset quality and income had improved over the

past year. A third institution had issues with commercial real estate loans and risk management, which Treasury decided had been mitigated in the first half of 2011.

However, while Treasury stated that it was aware of a fourth institution's poor earnings history, it was unaware that the institution's report of examination mentioned 7 years of less-than-satisfactory earnings. We spoke to the responsible FBA officials who stated that by the time the institution was under consideration, it had showed several years of improving earnings in line with projections. The FBA informed us that it, therefore, viewed the information in the report of examination as somewhat stale. The FBA had also generally informed Treasury of the institution's poor earnings history in its supervisory consultation memorandum. The dividend restriction was also at the subsidiary bank level and would not have disqualified the institution from participation in SBLF.

Treasury Gave Applicants Equal Opportunities for Reconsideration

To determine whether applicants had an equal chance for reconsideration, we evaluated a judgmental sample of 34 applicants that Treasury reconsidered after the ARC or the IC initially tabled them or recommended them for withdrawal. According to Treasury, the only intervening events that could result in reconsideration were receipt of either new information from the FBAs or second quarter financial results. Treasury informed us that if the IC could not recommend approval based on first quarter results, it would wait for second quarter results to become available before making a decision.

We determined that Treasury either received updated supervisory information from FBAs or updated financial data for all of the 34 applicants reconsidered, which was documented in the files for the applicants, IC minutes, or ARC minutes. Eighteen applicants were reconsidered based upon new supervisory information, while 16 were reconsidered based upon new financial data. Ultimately, 23 of these applicants were approved, and 11 were asked to withdraw.

Finally, the applicants' files contained no evidence of communication from parties other than the FBAs or financial analysts that Treasury engaged to help evaluate the applicants. If applicants or third parties asked for reconsideration, Treasury informed them that there was no appeals process. Therefore, it appeared that there was no undue influence when reconsidering institutions for approval.

Treasury Had Adequate Bases for Denying Funding to Institutions

The majority of the institutions denied funding in our sample was asked to withdraw their applications because they did not meet the basic eligibility requirements for the program. The Act prohibits Treasury from investing in institutions that are on the FDIC problem bank list or have been removed from the list within 90 days prior to application. It also prohibits the financing of TARP institutions that have missed more than one TARP dividend payment. Further, Treasury guidelines prohibit investments in institutions that are under dividend restrictions from their FBAs or state banking regulators.

Overall, 461 institutions were not admitted to the program of which 262 did not meet the basic eligibility requirements. We reviewed 51 applicants who met basic eligibility requirements, but were not admitted to the program. Of those reviewed, 32 were ineligible because they had dividend restrictions that could not be waived. As a result, they did not receive either ARC or IC review.

The remaining 19 applicants in the sample were eligible for the program and reviewed by the ARC or the IC. However, Treasury identified multiple risks associated with the ability of these applicants to meet their financial commitments under the program. For example, Treasury justified its decision not to invest in three institutions by noting that:

- The first institution had asset quality, management, earnings, and capital issues. One-third of the classified loans were outside the institution's natural market area and in distressed markets. Capital was below a requirement established in a memorandum of understanding with its regulator and earnings were weak. In addition, lender compensation was linked to portfolio size, creating incentives for risky loans.
- A second institution, a bank holding company, was under an enforcement action by its regulator. First-quarter financials showed further deterioration in the applicant's financial condition and its repayment probability was 28 percent. Further, the subsidiary bank had no earnings and could not pay dividends to the applicant holding company, which was currently paying its obligations from cash on hand.
- A third bank was deemed not viable by its FBA and was operating under an enforcement action. In its most recent examination, its

FBA had deemed capital unsatisfactory. Also, almost 100 percent of its assets were classified.

Therefore, Treasury documented its concerns with these institutions and identified issues that might reasonably have justified its decision not to invest.

Recommendation

Because the period of investment for the SBLF program has passed, we have made no recommendations for improving Treasury's investment decision process. However, previously we recommended, and Treasury agreed, to create an internal watch list for banks with more severe financial issues. This will ensure that Treasury has an opportunity to discuss with the banks' management their financial condition if it appears appropriate.

Management Comments and OIG Response

Treasury officials agreed with the report's findings that institutions approved for SBLF participation are likely to be able to repay Treasury's investment, it gave applicants equal opportunity for reconsideration based on consistent criteria, and there was no undue influence in the reconsideration process. In addition, Treasury agreed that it had adequate bases for denying funding to institutions not approved for program participation.

Treasury officials also stated that, as noted in the Recommendation section of the report, it has created and continues to maintain an internal review list of bank participants with certain financial issues. We consider management's comments to be responsive to the audit findings.

* * *

We appreciate the courtesies and cooperation provided to our staff during the audit. If you wish to discuss the report, you may contact me at (202) 622-1090, or Lisa DeAngelis, Audit Director, at (202) 927-5621.

/s/

Debra Ritt

Special Deputy Inspector General for

Office of Small Business Lending Fund Program Oversight

We conducted the audit of investment decisions regarding later-entry, withdrawn and reconsidered institutions in the Small Business Lending Fund (SBLF) program in response to our mandate under section 4107 of the Small Business Jobs Act of 2010.⁴ This section provides that the Office of SBLF Program Oversight is responsible for audit and investigations related to the SBLF program and must report at least twice a year to the Secretary of the Treasury and Congress on the results of oversight activities, including recommended program improvements.

Our audit objectives were to determine whether Treasury: (1) consistently approved institutions that were financially viable and able to repay the SBLF investments; (2) were consistent in how they considered institutions that were not approved and asked to withdraw their applications; and (3) had adequate bases for denying funding to institutions. We reviewed three populations: applicants approved and funded between July 27 and September 27, 2011 (during the last 60 days of the program); applicants that were asked by Treasury to withdraw from the SBLF program; and applicants that were reconsidered for SBLF funding.

To accomplish our first objective, we reviewed investment decision records for 47 randomly sampled institutions that Treasury approved and funded within the last 60 days preceding the program's September 27, 2011 funding deadline. These records included Investment Committee (IC) memoranda, Application Review Committee and IC minutes, and applicable correspondence. We also compared supervisory consultative memoranda from the institutions' regulators—the Federal Deposit Insurance Corporation (FDIC) and Office of the Comptroller of the Currency (OCC)—to the most relevant bank examination reports prepared by FDIC and OCC to determine whether they provided Treasury with robust and complete information regarding the financial health of the institutions. Where we identified issues from examination reports that had not been disclosed in supervisory memoranda we met with SBLF program staff to determine their awareness of the issues. We also attempted to review a sample of institutions regulated by the Federal Reserve Board (FRB), but the FRB declined to provide us with reports of examination until after the audit work was completed, creating a scope limitation for the first objective of this audit.

⁴ The Small Business Jobs Act of 2010, Public Law 111-240, was signed into law on September 27, 2010.

To accomplish our second objective, we reviewed documents supporting Treasury's investment decisions for a judgmental sample of 34 institutions that Treasury identified as being "reconsidered" for SBLF funding. We also reviewed updated financial and regulatory information recorded by Treasury subsequent to its initial review of the reconsidered institutions, and verified that Treasury was not informed of changes that had occurred in the financial condition of institutions that were not reconsidered. We interviewed SBLF staff, and officials from FDIC and OCC. We reviewed applicant files to identify evidence of communication from parties other than the FBAs or the financial analysts that Treasury used to evaluate the applications.

Finally, to accomplish our third objective, we reviewed investment decisions for a sample of 51 institutions that Treasury asked to withdraw from the program between June and September 2011. We obtained information from Treasury regarding the total number of statutorily ineligible applicants.

We conducted our fieldwork from October 2011 to May 2012 in accordance with Government Auditing Standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix 2
Management Response



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

June 27, 2012

Debra Ritt
Special Deputy Inspector General for
Office of Small Business Lending Fund Program Oversight
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Ms. Ritt:

Thank you for the opportunity to review your draft report (the Report) on the soundness of Small Business Lending Fund (SBLF) investment decisions for later-entry, withdrawn, and reconsidered institutions. This letter provides the Department of the Treasury's (Treasury) official response.

We reviewed the Report's findings, which reflect the SBLF program's comprehensive and transparent investment process. Your audit examined a significant number of SBLF applicants and considered information such as supervisory consultative memoranda from federal banking agencies, relevant bank examination reports, updated financial and regulatory information for some institutions, and documentation supporting Treasury's investment decisions. Treasury agrees with the Report's finding that institutions approved for SBLF participation are likely to be able to repay Treasury's investment.

Treasury also agrees that it gave applicants equal opportunity for reconsideration based on consistent criteria. Treasury only reconsidered an applicant upon receipt of new supervisory information or new financial information, and did not entertain individual requests for reconsideration. Therefore, as the Report finds, there was no undue influence in the reconsideration process.

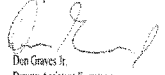
Finally, Treasury agrees that it had adequate bases for denying funding to institutions not approved for program participation. Treasury denied funding with consistency to applicants that did not meet eligibility requirements, were unable to pay dividends, or exhibited clear risks that could compromise the applicant's ability to meet financial commitments under SBLF.

In closing -- as noted in the recommendation section of the Report -- Treasury has created and continues to maintain an internal review list of bank participants with certain financial issues.

Thank you once again for the opportunity to review the Report. We look forward to working with you and your team in the future.

Appendix 2
Management Response

Sincerely,



Don Graves Jr.
Deputy Assistant Secretary

2

Appendix 3
Major Contributors

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Office of Strategic Planning and Performance Management
Office of Financial Management
Office of Accounting and Internal Control

Office of Management and Budget

OIG Budget Examiner

United States Senate

Chairman and Ranking Member
Committee on Small Business and Entrepreneurship

Chairman and Ranking Member
Committee on Finance

Chairman and Ranking Member
Committee on Banking, Housing and Urban Affairs

United States House of Representatives

Chairman and Ranking Member
Committee on Small Business

Chairman and Ranking Member
Committee on Financial Services

Government Accountability Office

Comptroller General of the United States

GAO

United States Government Accountability Office

Report to Congressional Committees

December 2011

SMALL BUSINESS LENDING FUND

Additional Actions Needed to Improve Transparency and Accountability



GAO-12-183



Highlights of GAO-12-183, a report to congressional committees

December 2011

SMALL BUSINESS LENDING FUND

Additional Actions Needed to Improve Transparency and Accountability

Why GAO Did This Study

The Small Business Jobs Act of 2010 aimed to stimulate job growth by establishing the Small Business Lending Fund program (SBLF) within the U.S. Department of the Treasury (Treasury), among other activities. The SBLF program was designed to encourage community banks and community development loan funds with assets of less than \$10 billion to increase their lending to small businesses.

The act also requires GAO to audit SBLF annually. This initial report examines (1) Treasury's procedures for evaluating applications for SBLF funds, (2) characteristics of institutions that applied for and received funds from SBLF and factors that influenced banks' decision to participate, and (3) Treasury's plans to monitor participants and measure SBLF's progress in increasing small business lending. GAO reviewed documents on Treasury's procedures and controls; analyzed data on applicants; compared SBLF banks with a peer group of nonparticipating banks; surveyed a representative sample of banks (for a weighted response rate of 66 percent); and interviewed Treasury, federal banking regulators, and representatives from industry associations.

What GAO Recommends

To improve transparency and accountability, Treasury should (1) enhance its strategy for communicating with participants and other stakeholders; (2) finalize procedures for monitoring participants' compliance with program requirements; and (3) complete plans for assessing the program's effectiveness. Treasury agreed with GAO's recommendations.

View GAO-12-183. For more information, contact A. Nicole Clowers at (202) 512-8678 or clowersa@gao.gov.

What GAO Found

Treasury adopted procedures to help ensure that applicants were evaluated consistently and were likely to repay funds, but its lack of clarity in explaining program requirements and decisions created confusion among applicants. The evaluation process included input from federal and state regulators, reviews of small business lending plans, and estimates of the applicants' ability to repay funds. GAO's analysis of the inputs Treasury relied on for its decisions showed that Treasury generally followed its process, although additional steps were taken for some applicants, such as revising repayment estimates to include updated information provided by federal regulators. Also, Treasury's initial announcement of program requirements did not make clear that applicants could not have restrictions on paying dividends, affecting over 200 applicants. Treasury also did not explain the rationale for its funding decisions to applicants and other stakeholders, and many applicants who were not approved were not notified until September 2011—almost 4 months after the application deadline and initial disbursements of funds. Although Treasury had several outreach efforts to communicate with the public about SBLF, such efforts have not always been timely or clear to applicants and other stakeholders and could contribute to SBLF being poorly understood by the public and Congress.

Fewer institutions applied to SBLF and received funding than initially anticipated, in part because many banks did not anticipate that demand for small business loans would increase. SBLF was authorized to invest up to \$30 billion, but Treasury funded just 332 of the 935 applications, investing about \$4 billion, or 13 percent, of the authorized funds. The institutions that applied to and were funded by SBLF were primarily institutions with total assets of less than \$500 million. In addition, GAO's analysis showed that compared with banks that did not apply to SBLF, funded banks had fewer problem loans and small loans (under \$1 million) and less capital. GAO's nationally representative survey of community banks showed that respondents' most common reason for not applying to the SBLF program was a lack of demand for small business loans.

Treasury has not finalized plans for assessing SBLF's impact on small business lending or procedures for monitoring recipients for compliance with program requirements. GAO's analysis shows that credit is still difficult to obtain, although it has eased some compared with 2009, confirming that the lending environment remains challenging. Such an environment makes Treasury's planned monitoring and assessments increasingly important. Treasury officials told GAO that they have been developing procedures for monitoring compliance, but they are not yet finalized. Similarly, Treasury is considering various options for evaluating SBLF's performance, but complex economic relationships will make linking the SBLF program to job growth difficult. Treasury officials said that they had been focused on approving applicants and disbursing funds by the statutory deadline of September 27, 2011, and that finalizing procedures and performance indicators had lagged as a result. Now that funding decisions and disbursements have been made, finalizing plans for monitoring compliance and assessing SBLF's progress can take precedence. Without a full and robust assessment, Treasury will not be able to provide useful information to policymakers about the participants' compliance and the effectiveness of a capital infusion program as a means of increasing small business lending.

United States Government Accountability Office

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Abbreviations

ABA	American Bankers Association
call reports	consolidated reports of condition and income
CAMELS	C-Capital adequacy, A-Asset quality, M-Management quality, E-Earnings, L-Liquidity, and S-Sensitivity to market risk
CDCI	community development capital initiative
CDFI	community development financial institution
CDLF	Community Development Loan Funds
CPP	Capital Purchase Program
FDIC	Federal Deposit Insurance Corporation
Federal Reserve	Board of Governors of the Federal Reserve System
GPRA	Government Performance and Results Act of 1993
ICBA	Independent Community Bankers Association
NFIB	National Federation of Independent Business
OCC	Office of the Comptroller of the Currency
OTS	Office of Thrift Supervision
SBLF	Small Business Lending Fund
SBLI	Small Business Lending Index
SNL	SNL Financial—collects and publishes financial data and analyses
TARP	Troubled Asset Relief Program
Treasury	Department of the Treasury
IG	Inspector General

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United States Government Accountability Office
Washington, DC 20548

December 14, 2011

Congressional Committees

Congressional interest in assisting small businesses has increased in recent years, primarily because of continued concerns about unemployment and the sustainability of the current economic recovery. In particular, Congress has grown increasingly concerned that in the current economic recovery small businesses might not be able to access enough capital to create needed jobs. In 2008 and early 2009, major disruptions of business credit markets made accessing credit difficult for small businesses. For example, a Wells Fargo survey shows that the number of small businesses having difficulty accessing credit more than tripled from 2007 to 2010, with ultimately almost 40 percent of small businesses indicating that credit was difficult to obtain. Further, the Secretary of the Treasury testified in June 2011 that small businesses were concentrated in sectors that had been especially hard hit by the recession, including construction-related industries. As a result, during the depths of the 2007-2009 crisis, the rate of job losses was almost twice as high for small businesses as it was for larger firms.¹

To address these concerns, on September 27, 2010, President Obama signed into law the Small Business Jobs Act of 2010.² Among other things, this legislation aims to stimulate job growth by establishing the Small Business Lending Fund program (SBLF). The SBLF program is designed to encourage banks and community development loan funds (CDLF) with assets of less than \$10 billion to increase their lending to small businesses with up to \$50 million in annual revenues.³ The act authorizes the Treasury Secretary to make up to \$30 billion of capital available and offers incentives to increase small business lending.

¹House Committee on Small Business, *The State of Small Business Access to Capital and Credit: The View from Secretary Geithner*, 112th Cong., 1st sess., 2011.

²Pub. L. No. 111-240, 124 Stat. 2504 (2010).

³In this report, "banks" refers to banks, thrifts, and bank and thrift holding companies. For the purposes of the SBLF program, a CDLF is an entity that is certified by Treasury as a community development financial institution (CDFI) loan fund. CDFI is a specialized financial institution that works in market niches that are underserved by traditional financial institutions.

Although the SBLF program has received support from some members of Congress and banking and business trade groups, other congressional members and groups have raised concerns about the program. These concerns include protecting taxpayer money (that is, ensuring that the funds will be paid back), ensuring that only healthy institutions have access to the funds, and ensuring that the institutions receiving the funds will actually increase new business lending. Some others have also expressed concerns that allowing institutions that received funds under the Troubled Asset Relief Program (TARP) to draw on SBLF funds would offer a way to refinance out of TARP with lower dividend rates and fewer program restrictions but without any guarantee of increasing business lending. Legislation has been introduced in Congress intended to address program concerns.⁴

The 2010 Small Business Jobs Act requires GAO to conduct an annual audit of the SBLF program. Under this statutory mandate, this initial report assesses (1) the Department of the Treasury's (Treasury) procedures to implement SBLF and evaluate applications for SBLF funds, (2) characteristics of institutions applying for and receiving SBLF funds and the factors that influenced banks' decision to participate, and (3) Treasury's plans to monitor SBLF participants and measure the SBLF's progress in increasing small business lending.

To assess Treasury's evaluation process for SBLF applications, we reviewed Treasury's policies, procedures, and internal controls for SBLF, including nonpublic documents and publicly available material from the SBLF website. We reviewed Treasury's and the four federal banking regulators'—Federal Deposit Insurance Corporation (FDIC), Board of Governors of the Federal Reserve System (Federal Reserve), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS)—respective roles and responsibilities and compared them with their roles for the Capital Purchase Program (CPP), a capital

⁴S. 681, 112th Cong. (2011). On April 6, 2011, members of the House also introduced a bill to give TARP's Special Inspector General oversight of the SBLF. H.R. 1387, 112th Cong. (2011).

infusion program under TARP that is similar to SBLF.⁵ To identify applicants that fell outside of Treasury's stated evaluation parameters, we analyzed data that Treasury used to inform its funding decisions, including CAMELS composite ratings, repayment probabilities, performance ratios, lending plan scores, dividend restriction information, and results of regulators' financial condition assessments.⁶ We also analyzed data from Treasury, FDIC, and SNL Financial (SNL)—a financial institution database—for all applicants. We then compared the applicants that Treasury approved and did not approve to its evaluation thresholds and identified a number of approved and nonapproved applicants that fell outside of these general parameters. Using the results of this analysis, we then selected a judgmental sample of 15 applicants that appeared to be particularly out of line with the parameters Treasury had set for additional review. We obtained the relevant minutes from Treasury's Application Review Committee and Investment Committee for these 15 applicants to review Treasury's rationale for their decisions on these applicants. We interviewed Treasury officials for further clarification. We also interviewed representatives of industry trade groups to obtain their perspectives on SBLF and the application process. Our criteria for assessing Treasury's evaluation process drew from GAO's Standards for *Internal Control in the Federal Government* and past IG and GAO work, particularly on CPP.⁷

⁵The Dodd-Frank Act eliminated the OTS, which chartered and supervised federally chartered savings institutions and savings and loan holding companies. Rulemaking authority previously vested in the OTS was transferred to the OCC for savings associations and to the Federal Reserve for savings and loan holding companies. Supervisory authority was transferred to the OCC for federal savings associations, to the FDIC for state savings associations, and to the Federal Reserve for savings and loan holding companies and their subsidiaries, other than depository institutions. The transfer of these powers was completed on July 21, 2011, and OTS was officially abolished 90 days later (Oct. 19, 2011). 12 U.S.C. §§ 5411-5413.

⁶The CAMELS rating system is a U.S. supervisory tool that describes a bank's overall condition and that is used to classify the nation's banks. The composite rating is based on financial statements and regulators' on-site examinations and has six components—capital adequacy, asset quality, management, earnings, liquidity, and sensitivity to market risk—that make up the acronym. It rates banks on a scale of 1 to 5, with 1 being the strongest. Evaluations of the six CAMELS components take into consideration a bank's size and sophistication, the nature and complexity of its banking activities, and its risk profile.

⁷GAO, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999).

To describe the characteristics of the institutions that applied to and received SBLF program funds, we analyzed data from Treasury on applicants and participants, including the number of institutions that were approved, not approved, and those that were refinancing their CPP or CDCI funds through SBLF.⁸ We also analyzed the geographic distribution of participants and assessed the extent to which institutions receiving SBLF funds tended to be located in high unemployment areas. We also developed a comparable peer group of banks that did not apply for SBLF program funds and compared their financial condition and past lending patterns with those of SBLF program applicants and participants that are also banks. The data we analyzed from Treasury, FDIC, and regulatory filings were sufficiently reliable to describe the characteristics of SBLF bank applicants and their peers. Finally, we conducted a Web-based survey of a nationally representative sample of banks with assets of \$10 billion or less to obtain their reasons for applying or not applying to the program. The weighted response rate was 66 percent.⁹ On the basis of our application of generally accepted survey design practices, we determined that the data collected via our survey were of sufficient quality for our purposes.

To assess Treasury's plans to measure SBLF's effectiveness, we interviewed Treasury officials about their intended work. To describe trends in small business lending, we used a number of indicators that provide a variety of perspectives on small business credit market conditions leading up to the implementation of SBLF. Appendix I contains more information on our objectives, scope, and methodology.

We conducted this performance audit from December 2010 to December 2011 in Washington, D.C., in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

⁸Community Development Capital Initiative (CDCI) is part of the TARP program that makes capital available to certain certified CDFIs for the purposes of increasing lending to small businesses and other community development projects.

⁹The weighted response rate accounts for the differential sampling fractions within strata. More information can be found in appendix II.

Background

SBLF Goals, Considerations, and Eligibility Requirements

SBLF was one of the key provisions under the 2010 Small Business Jobs Act to address the ongoing effects of the financial crisis on small businesses. The act provided temporary authority to the Secretary of the Treasury to make capital investments in eligible banks and CDLFs in order to increase the availability of credit for small businesses. The legislation directed Treasury to consider the following in exercising its authorities for the SBLF program:

- increasing the availability of credit for small businesses;
- providing funding to minority-owned eligible institutions and other eligible institutions that served small businesses that were minority-, veteran-, and women-owned and that also served low- and moderate-income, minority, and other underserved or rural communities;
- protecting and increasing American jobs;
- increasing the opportunity for small business development in high-unemployment areas;
- ensuring that all eligible institutions can apply, without regard to geographic location;
- providing transparency with respect to the use of SBLF funds;
- minimizing costs to taxpayers;
- promoting and engaging in financial education for would-be borrowers; and
- providing funding to eligible institutions that served small businesses directly affected by the Deepwater Horizon spill.

SBLF is intended to increase small business lending. For the purposes of the program, the legislation defined qualified small business lending—as

defined in an institution's quarterly regulatory filings (call reports)—as one of the following:¹⁰

- commercial and industrial loans;
- owner-occupied nonfarm, nonresidential real estate loans;
- loans to finance agricultural production and other loans to farmers; and
- loans secured by farmland.

In addition, qualifying loans cannot be for more than \$10 million, and the business may not have more than \$50 million in revenue.¹¹

The act specifically restricts applications from institutions that are on the FDIC problem bank list (i.e., defined in the act as banks with a composite CAMELS ratings of 4 or 5) or have been removed from that list in the previous 90 days.¹² Treasury determines whether to provide SBLF funding to a bank after consulting with the appropriate federal and, if applicable, state banking regulator. The Small Business Jobs Act outlined different statutory financial eligibility criteria for CDLFs. To qualify for SBLF, CDLFs must meet a number of requirements, including having at least 3 years of operating experience.

SBLF Application Process and Requirements

Applicants submitted a 1-page application to Treasury and a 3-page small business lending plan to their primary federal regulator to (1) describe how they would use SBLF funds to address the needs of small businesses in the communities they served; (2) specify the projected

¹⁰A call report is the common reference name for the quarterly reports of condition and income filed with regulators by every national bank, state-chartered Federal Reserve member bank, and insured state nonmember bank.

¹¹Treasury's guidance also excludes loan portions guaranteed by the Small Business Administration and those for which a third party assumes risk.

¹²The problem bank list is a confidential list created and maintained by the FDIC listing banks that are in jeopardy of failing. In general, "problem" institutions are those institutions with financial, operational, or managerial weaknesses that threaten their continued financial condition. Depending upon the degree of risk and supervisory concern, they received a composite CAMELS rating of either "4" or "5".

increase in small business lending they expected to achieve 2 years after receiving SBLF funds; and (3) describe their approach to community outreach and advertising for small business lending, especially to minority-, veteran- and women-owned businesses via radio, television, or electronic media.

For banks, Treasury implemented the SBLF program with supervisory consultation from the four federal banking regulators: FDIC, Federal Reserve, OCC, and OTS. After Treasury conducted an initial eligibility review for each applicant, Treasury requested that the regulators provide a supervisory consultation for eligible applicants, focusing on their financial condition and the results of the most recent examination. Regulators recorded their assessment in a Supervisory Consultation Memo to Treasury. For CDLFs, Treasury sought input from the Community Development Financial Institutions Fund, a bureau in Treasury that certifies these institutions.

SBLF Funding and Incentives for Small Business Lending

Under SBLF, Treasury can make capital investments in eligible institutions with total assets of less than \$10 billion. Treasury provides institutions with capital by purchasing preferred stock or subordinated debt in each bank.^{13,14} The amount of funding a institution could receive depended on its asset size as of the end of the fourth quarter of calendar year 2009. Specifically, if the qualifying bank had total assets of \$1 billion

¹³Some banking institutions are reformed as either S-corporations (S-corps) or mutual organizations (mutuals) which will affect the form of Treasury's investment. An S-corporation makes a valid election to be taxed under subchapter S of chapter 1 of the Internal Revenue Code and thus does not pay any income taxes. Instead, the corporation's income or losses are divided among and passed through to its shareholders. A mutual organization is a company that does not issue capital stock and, therefore, has no shareholders. It is also "owned" by its members (e.g., deposit customers) rather than by stockholders. Many thrifts and insurance companies are mutuals. Insurance companies are not eligible to participate in SBLF.

¹⁴The capital is in the form of Tier 1 capital for banks that issue preferred stock to Treasury. Tier 1 capital is considered the most stable and readily available capital for supporting a bank's operations. It covers core capital elements, such as common stockholder's equity and noncumulative perpetual preferred stock. The SBLF funds are Tier 2 capital for institutions that are subchapter S Corps and Mutuals and that issue subordinated securities to Treasury. According to the June 13, 2011, interim final rule from the Federal Reserve, S-Corp and Mutual bank holding companies with less than \$500 million in consolidated assets may exclude the SBLF subordinated securities from debt. CDLFs issue unsecured equity equivalent capital that does not constitute a class of stock or represent equity ownership in the issuer.

or less, it could apply for SBLF funding that equals up to 5 percent of its risk-weighted assets (as reported in the call report immediately preceding the date of application).¹⁵ If the qualifying bank had assets of more than \$1 billion, but less than \$10 billion, it could have applied for funding that equals up to 3 percent of its risk-weighted assets. The SBLF program also provides an option for eligible institutions to refinance preferred stock issued to the Treasury through TARP's CPP or CDCI. If the qualifying institution is a CPP or CDCI recipient, any capital that remains outstanding from these investments is deducted from the SBLF program limits. All CPP and CDCI outstanding amounts must be repaid when SBLF funding is received.

Participating banks must pay dividends or interest of 5 percent per year initially, with reduced rates available if they increase their small business lending. Specifically, the dividend rate payable will decrease as banks increase small business lending over their baselines. While the dividend rate will be no more than 5 percent for the first 2 years, a bank can reduce the rate to just 1 percent by generating a 10 percent increase in its lending to small businesses compared with its baseline. After 2 years, the dividend rate on the capital will increase to 7 percent if participating banks have not increased their small business lending and, after 4 1/2 years, the dividend rate on the capital will increase to 9 percent for all banks. For CDLFs, the initial dividend rate will be 2 percent for the first 8 years. After the eighth year, the rate will increase to 9 percent if the CDLF has not repaid the SBLF funding. This structure is designed to encourage CDLFs to repay the capital investment as soon as practicable. With the approval of its regulator, Treasury will allow SBLF participants to exit the program at any time simply by repaying the funding provided along with dividends owed for that period. Treasury requires that institutions that are participants in CPP or CDCI must increase their small business lending to receive a reduced dividend rate benefit from refinancing. Specifically, if a

¹⁵Treasury may require matching private capital and limit SBLF funding to 3 percent of risk-weighted assets. Risk-weighted assets are weighted according to credit risk and are used in the calculation of required capital levels. Specifically, all assets are assigned a risk weight according to the credit risk of the obligor or the nature of the exposure and the nature of any qualifying collateral or guarantee, where relevant. Off-balance sheet items, such as credit derivatives and loan commitments, are converted into credit equivalent amounts and also assigned risk weights. The risk weight categories are broadly intended to assign higher-risk weights to—and require banks to hold more capital for—higher-risk assets, and vice versa. See 12 C.F.R. Part 3 (OCC); 12 C.F.R. Part 208 and Part 225, App. A & B (Federal Reserve); 12 C.F.R. Part 325 (FDIC); and 12 C.F.R. Part 567 (OTS).

institution's business lending has not increased over its baseline (i.e., the amount that was outstanding in the four quarters ending June 30, 2010) amount by the ninth quarter, it will be required to pay a "lending incentive fee" equal to 2 percent per year on the total amount of outstanding SBLF funding.

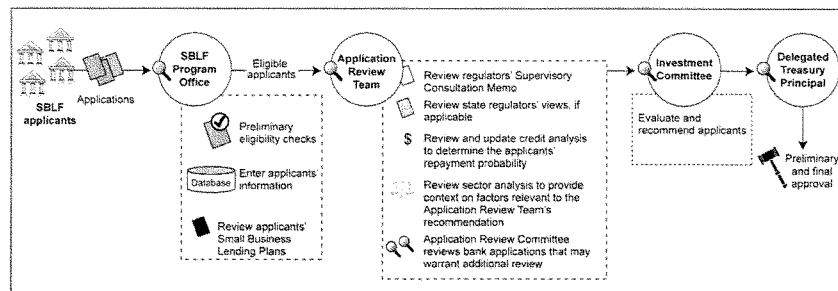
Institutions chosen to participate in SBLF must submit an Initial Supplemental Report to Treasury that calculates the baseline level of small business lending and the initial dividend rate. SBLF institutions must continue submitting Quarterly Supplemental Reports to calculate dividend rates for the next quarter. The goal is to measure the institution's changes in qualified small business lending to determine changes, if any, to the dividend rate. In addition, SBLF institutions must complete a short annual lending survey and annual certifications to Treasury that attest the accuracy to the institutions' reports, among other things. In accordance with the act, Treasury plans to measure institutions' changes in qualified small business lending by the amount of loans outstanding each quarter against the baseline level.

Treasury's Application Requirements and Decisions Were Not Always Transparent

Treasury's Review Process Required Additional Steps to Evaluate Some Applicants

Treasury's process for evaluating SBLF applicants included several levels of review and input from multiple sources to help ensure that applicants were treated consistently and that banks approved for funding were financially viable and could repay the investments. Such procedures are an important control activity that helps ensure agency accountability over the use of government resources. Treasury's review focused primarily on the financial condition of applicants and drew not only on regulators' supervisory consultation, but also on an independent credit analysis of applicants' financial health—specifically, the likelihood that they would be able to repay SBLF investments and accompanying dividends—and to a lesser extent on the applicants' small business lending plans. Figure 1 provides an overview of the process for evaluating SBLF applicants.

Figure 1: Treasury's Process for Evaluating SBLF Applicants



Sources: GAO analysis of Treasury information; An Explosion (images).

First, Treasury checked whether applicants were eligible to participate in SBLF. For example, Treasury checked to make sure that the applicants had less than \$10 billion in assets and were not on FDIC's problem bank list. Treasury also checked with the regulators to determine whether the applicants could pay dividends to Treasury, a process which we describe in more detail later. Furthermore, for applicants seeking to refinance their CPP or CDCI funds, Treasury checked to ensure that they had not missed more than one dividend payments under the program. The program office then entered applicants' information into a database.

Second, the Application Review Team considered various inputs for eligible applicants to help develop a preliminary recommendation to forward to the Investment Committee. According to Treasury, the Application Review Team included five members from Treasury with investment analysis experience to manage the application review process.¹⁶ The inputs that the Application Review Team considered included the following:

¹⁶As the number of applications increased over time, Treasury requested additional support from the regulators. The Federal Reserve, FDIC, and OTS provided a total of four senior financial analysts as detailees, who acted as Treasury employees, to review applicants.

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- *Supervisory consultation memo:* As part of the evaluation process, Treasury obtained supervisory consultation from the appropriate federal banking regulators to determine the financial condition and performance of applicant banks. In the memo, the regulators did not recommend whether the applicant should be approved; rather the memo summarized supervisory information (e.g., CAMELS composite ratings and a description of material supervisory issues, if any) about the applicant's financial condition and performance and specifically indicated whether the applicant was viable.¹⁷ "Viable" was defined as adequately capitalized, not expected to become undercapitalized, and not expected to be placed into conservatorship or receivership.¹⁸
 - *Repayment probability:* The Application Review Team also considered an independent credit analysis of applicant's ability to repay SBLF investments while making consistent dividend payments to Treasury—which was referred to as the "repayment probability." Treasury hired financial agents to conduct this analysis. Using publicly available information, these agents examined applicants' capital structure, asset quality, earnings capacity, and access to funding to develop a repayment probability estimate. According to Treasury officials, the purpose of the repayment probability analysis was to provide a forward-looking approach to help ensure that participants would generate enough future income to repay the SBLF investments and not solely rely on a determination of the applicant's financial condition information from their respective regulators. According to Treasury officials, the Application Review Team reviewed the repayment probability estimate and, if needed, updated the estimate to incorporate confidential supervisory information.
 - *Sector analysis:* The Application Review Team reviewed sector analyses, on an as needed basis, on current industry trends and developments in the small bank credit sector because comparatively little market research was available. For example, some of the sector analyses included analysis of regional economies or summaries of important industry information, such as proposed regulatory and

¹⁷Specifically, OCC used three conclusions: (1) nonobjection, (2) nonobjection conditioned on private capital raised of a specified amount, or (3) unable to support the request for SBLF funding to provide information for Treasury's evaluation. OTS also provided a "positive" or "negative" assessment on each applicant.

¹⁸SBLF staff also requested input from state banking regulators, but state regulators were not required to provide it.

legislative changes. Treasury hired financial agents to perform the sector analysis.

- *Small business lending plans:* The Application Review Team summarized input from SBLF Program Office's evaluation of applicants' small business lending plans. The evaluation included the projected increase in small business lending, experience in small business lending, and plans to meet the needs of small businesses or provide appropriate outreach.¹⁹
- *Application Review Committee input:* The Application Review Team considered input from the Application Review Committee, which was made up of detailees from the FDIC, Federal Reserve, and OCC who were experienced in bank examinations.²⁰ Treasury established the Application Review Committee to further help ensure consistent treatment of bank applicants. The Application Review Committee was responsible for all bank applications that may have warranted additional review. For example, the Committee reviewed all applicants that receive a CAMELS composite rating of "3," had adverse performance ratios, or received inconsistent supervisory consultation from the relevant state and federal regulators.²¹ In addition, the Application Review Committee took a "second look" at applicants deemed not viable by their respective regulators to ensure that the supervisory consultation process had been applied consistently

¹⁹In particular, the SBLF Program Office reviewed the Small Business Lending Plans to determine if applicants include key information, such as (1) the communities served and the SBLF's ability to meet their lending needs; (2) loan demand in the communities served, including a quantitative assessment by loan or business type; (3) the applicant's historical small business lending growth and experience; (4) participation in Small Business Administration, U.S. Department of Agriculture, or state small business lending programs; (5) the resources that the applicant dedicated to small business lending activities; (6) the role of small business lending within the applicant's overall corporate strategies and business objectives; (7) current qualified small business lending as a percentage of total loan portfolios; and (8) the applicant's use of general media outlets for outreach; and (9) the applicant's targeting of individuals that represent, work with or are women, minorities, or veterans.

²⁰These detailees worked as Treasury employees and were compensated by Treasury during their assignment on the Application Review Committee. They were not serving on behalf of their respective regulators.

²¹Treasury used three key performance ratios for evaluating applicants that measured the following types of assets, as a percentage of capital reserves: classified assets, nonperforming loans, and construction and development loans. For a more detailed discussion on the specific parameters for these key ratios, see appendix i.

across bank applicants. Treasury said that it added this additional review by the Application Review Committee in response to a previous GAO recommendation.²² The review process ends at this stage for applicants that the Application Review Committee did not recommend for further consideration and they are no longer considered for SBLF funding. According to Treasury, these decisions were further reviewed and affirmed by the Deputy Assistant Secretary.

Third, the Application Review Team then prepared a recommendation for the Investment Committee. The Investment Committee was a five-member body that included the SBLF Director (Chairman) and the Assistant Secretaries for Financial Institutions, Financial Markets, Economic Policy, and Management or their delegates. The Investment Committee was charged with reviewing and recommending applicants for funding and reviewed the information compiled by the Application Review Team to inform its recommendations. Applications recommended by the Investment Committee were presented for preliminary approval to the Deputy Assistant Secretary for Small Business, Community Development, and Affordable Housing Policy. After preliminary approval, the approved bank had 30 days to close the transaction.²³

Because CDLFs are unregulated institutions, they do not face the same regulatory reporting requirements as banks and, because of differences in legislative requirements, Treasury developed a separate set of processes to evaluate their ability to meet the eligibility requirements and financial conditions. Treasury consulted with the CDFI fund to determine whether a CDLF applicant could receive SBLF funding on the basis of factors such as prior award history, compliance status, and certification requirements. To evaluate the CDLF's financial condition, Treasury hired a financial agent to perform a desk review and on-site visit to evaluate the CDLF's

²²In our 2010 report on CPP, we found that because Treasury relied on the regulators to make recommendations for CPP investments, it had limited oversight of regulators' reasons for recommending withdrawals from the program. As a result, CPP participants might not have received equal treatment. We recommended that Treasury establish a process to monitor applicants for programs similar to CPP to ensure that they were treated equitably. For more information on our recommendation, see GAO, *Troubled Asset Relief Program: Opportunities Exist to Apply Lessons Learned from the Capital Purchase Program to Similarly Designed Programs and to Improve the Repayment Process*, GAO-11-47 (Washington, D.C.: Oct. 4, 2010).

²³Some applicants had less than 30 days to close because Treasury's decisions to approve them were made after August 30, 2011.

financial statements, risk management and control procedures, adequacy of information systems, and management structure. The Application Review Team considered these inputs and then made a funding recommendation for the Investment Committee. CDLF applicants recommended for approval by the Investment Committee were then provided to the Deputy Assistant Secretary for preliminary approval. Those that were not recommended were also reviewed and affirmed by the Deputy Assistant Secretary.

Our analysis of funding decisions found that Treasury generally followed its procedures, but we also identified some decisions that appeared to fall outside certain key parameters Treasury had established to guide its evaluation process. Treasury established specific parameters to evaluate SBLF applicants' financial conditions and, to a lesser extent, their small business lending plans. These parameters included that applicants should have at least an 80 percent probability of repayment and satisfactory performance ratios (e.g., nonperforming loan ratios of less than 40 percent, and construction and development loan ratios of less than 300 percent, Treasury's stated thresholds).²⁴ Treasury also considered the applicants' CAMELS composite ratings. For the evaluation criteria that we reviewed, we found the following for approved and nonapproved applicants:

- *Approved applicants.* Our review of Treasury data showed that 400 of the 935 applicants were approved. Treasury gave preliminary approval to a total of 400 SBLF applicants and funded 332. The remaining 68 of the approved applicants either chose not to participate in SBLF or were ultimately not approved because Treasury had evaluated updated information after they sent out the preliminary approval letter. All the approved applicants did not have restrictions on paying dividends. We also found that all approved applicants had CAMELS composite ratings of 1, 2, or 3 and had construction and development loan ratios of less than 300 percent. In addition, all but two approved applicants had what Treasury considered "responsive

²⁴We selected key inputs used by Treasury to guide its decisions and performed an analysis for all 935 applicants to determine which applicants, both approved and nonapproved, fell out of Treasury's stated parameters for the various inputs. We did not review the evaluation documents, such as regulator's supervisory consultation memos, minutes from the Application Review and Investment Committees for all 935 applicants. For a more information on our methodology, see appendix I.

lending plans.”²⁵ However, we found that 44 of the 400 (11 percent) approved applicants had an initial calculation of repayment probability of less than 80 percent. The lowest repayment probability estimate for an approved bank was 48 percent. In addition, we found that 13 of the 400 (3.2 percent) approved applicants had nonperforming loan ratios (as a percentage of capital and loan loss reserves) greater than 40 percent (based on first quarter 2011 data).²⁶

- *Nonapproved applicants.* Our analysis showed that, out of 935 applicants, a total of 535 applicants were not approved.²⁷ Fifty-three of the nonapproved applicants were not eligible based on Treasury’s initial eligibility check. Of the nonapproved applicants, 175 applicants considered viable by their respective regulator(s) and able to pay dividends were ultimately not approved.²⁸ Of these nonapproved applicants, 85 (48.6 percent) had a CAMELS composite rating of 2, and 49 (28 percent) had both a CAMELS composite rating of 2 and an initial calculation of repayment probability of higher than 80 percent.²⁹

To examine the decisions that appeared to fall outside of Treasury’s stated parameters in more depth, we judgmentally selected 15 applicants that appeared to be particularly out of line with Treasury’s evaluation parameters. As part of this analysis, we reviewed minutes from the Application Review Committee and Investment Committee and interviewed Treasury officials. According to Treasury, these committees had the flexibility to consider all factors—supervisory information, financial data, as well as repayment probability—relating to the applicants’ financial health in making their decisions. For 12 of the 15 applicants, the

²⁵For the remaining two, the lending plan was not responsive because the projected small business lending increase was not greater than or equal to amount requested. Treasury’s documents indicated that one was rewarded less than what they asked for, and the other one had an amount that was a bit shy of this threshold, but was ultimately approved.

²⁶Treasury officials suggested that loss share agreements and other guarantees—that protect banks against risk of losses from certain nonperforming assets—could explain accepted applicants with elevated ratios of nonperforming loans.

²⁷Treasury officials noted that a number of the 535 nonapproved applicants withdrew from the application process prior to Treasury’s evaluation.

²⁸Treasury indicated that they subsequently found that 16 of the 175 applicants either had dividend restrictions or withdrew before Treasury’s consideration.

²⁹None of these banks had a CAMELS score of 1.

Investment Committee's minutes and other documents provided additional explanation for their decisions. In particular, Treasury's Investment Committee minutes generally indicated that the financial agent's probability estimate was deemed too conservative for the approved applicants with repayment probabilities of less than 80 percent because, for example, the estimates did not include confidential supervisory information. For the remaining three applicants, Treasury officials were able to explain the rationale for their decisions—for example, we learned that the Application Review Committee or Investment Committee discussed concerns about the applicants' financial condition, but these concerns were not clearly documented in the committees' minutes. Treasury officials were able to clarify their decisions in subsequent conversations with us. Specifically, 2 nonapproved applicants from the 15 applicants that we reviewed in more depth were deemed viable by their regulators, were able to pay dividends, and had a 96 percent repayment probability. However, the Application Review Committee did not recommend that these applicants go forward and the committee's minutes documented that both applicants had asset quality problems. Treasury officials further explained that financial agents estimated a high repayment probability for these applicants but lacked access to certain confidential supervisory information that would have lowered the repayment probability estimates. In particular, the financial agent projected a low level of losses, but the Application Review Team estimated that the applicants could have a higher level of losses based on confidential supervisory information about the applicants' classified assets—a measure of assets with well-defined weaknesses that jeopardize the liquidation of debts.

Treasury officials acknowledged that the initial repayment probability provided by the financial agents did not reflect regulators' views of the financial condition of the banks, especially confidential information concerning adversely classified assets. According to Treasury officials, this was due to the financial agents' reliance on only publicly available information to develop the repayment probability. Therefore, additional steps were taken to revise the estimates in certain cases. Treasury officials explained that the Application Review Team updated the probability estimate with confidential supervisory information in certain cases to help inform Investment Committee's evaluations. While these updated repayment probability estimates were considered, they were not recorded in Treasury's database. However, Treasury officials explained

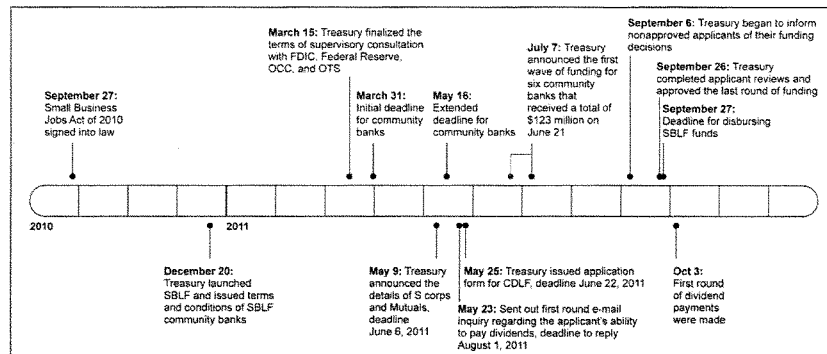
that this updated information was typically included in either the Application Review Team's recommendation memorandum to the Investment Committee or the Investment Committee minutes.³⁰

Time to Review
Applications Was Affected
by Implementation
Challenges and Funding
Deadline

Treasury faced multiple delays in implementing the SBLF program and disbursing SBLF funds by the statutory deadline of September 27, 2011. Treasury launched the program in December 2010 and had initially intended to start approving applications by mid-January 2011 and begin closing the application window by early April 2011. However, Treasury extended the application deadline for community banks from March 31 to May 16, 2011. In addition, Treasury did not begin the application process for banks that were S Corps and Mutuals and CDLFs until May 12, 2011, and set application deadlines for these institutions for June 6, 2011, and June 22, 2011, respectively. Because of these implementation delays, Treasury did not disburse any funds until the end of June 2011, and finished approving the applicants on September 26, 2011, a day before the funding deadline (see fig. 2).

³⁰A Treasury IG official told us that the next IG report will focus on Treasury's evaluation process and will review a sample of decisions more in depth, including the role of the repayment probability estimates in Treasury's funding decisions.

Figure 2: Timeline for the Implementation of SBLF, September 2010 through October 2011



Source: GAO.

Treasury officials said that they encountered a number of implementation challenges that delayed the disbursement of SBLF funds. First, the need to develop SBLF's infrastructure, including hiring staff and contractors, contributed to delays in starting the applicant review process. Second, Treasury officials noted that while they wanted to expeditiously disburse the funds, they were committed to developing and implementing a robust set of internal controls, which can take time. Third, negotiations over the regulators' role in reviewing SBLF applicants for investments took much longer than anticipated, and an agreement was not reached until March 2011. According to Treasury, this delay resulted from differing views among the federal regulators—FDIC, Federal Reserve, OCC, and OTS—about whether they should make recommendations to Treasury. Ultimately, the regulators and Treasury agreed that the regulators would not be required to make recommendations on whether the applicant should be approved for SBLF but instead would document their analyses of SBLF applicant's financial condition and performance and determination of the applicant's viability in the Supervisory Consultation.

Memo to inform Treasury's evaluation.³¹ Treasury also agreed to protect the privacy of the confidential supervisory information the regulators provided through a memorandum of understanding or similar letter agreements.

Treasury also reconsidered applicants that had not been approved upon their initial review through September, when new supervisory information became available. Treasury officials explained that they continued to receive updated supervisory information from regulators through September, often because some banks had gone through a more recent examination. Treasury officials wanted to reevaluate the nonapproved bank applicants using this updated information to ensure that these applicants were fully considered. Therefore, Treasury delayed making final decisions for some applicants so that updated supervisory information could be considered. According to Treasury officials, waiting for such information proved beneficial for 18 applicants that were ultimately approved to participate in SBLF.

Lack of Clarity about Program Requirements and Transparency of Some Decisions Created Confusion

Treasury did not explicitly explain to applicants all SBLF program requirements at the beginning of the application period and did not inform nonapproved applicants of their status in a timely manner, which created confusion among applicants. Treasury initiated several outreach efforts to educate the public and potential applicants about SBLF. These efforts included a website with background and guidance on the program and frequently asked questions. Treasury also established a call center to respond to inquiries from interested institutions and held several webinars to explain the program. However, these communication efforts were not sufficient to address unexpected developments and the delays in the program. Furthermore, Treasury's communication strategy did not appear to be effective in communicating with external stakeholders such as the banking regulators, industry associations, and Congress. Two key developments illustrate these weaknesses.

Program Requirements and Dividend Restrictions

Treasury did not clearly explain one of the program requirements to SBLF applicants—that they needed to be able to pay dividends on SBLF funds

³¹Specifically, OCC used three conclusions: (1) nonobjection, (2) nonobjection conditioned on private capital raised of a specified amount, or (3) unable to support the request for SBLF funding to provide information for Treasury's evaluation. OTS also provided a "positive" or "negative" assessment on each applicant.

they received—during the application process, leading to confusion among many applicants about the program. After the application deadline for banks, Treasury realized that the information from federal regulators would not necessarily indicate whether banks had dividend restrictions. For example, dividend restrictions may come from state regulators and the applicant's own board of directors and, therefore, would not be reflected in the federal regulators' supervisory information.³² To obtain this information, in May 2011, Treasury sent applicants an e-mail asking them to fill out a new form about their ability to pay dividends. In its request, Treasury did not explain that this was not a new requirement.

According to industry representatives, many banks had not realized that demonstrating their ability to pay dividends was a requirement for eligibility and, therefore, viewed Treasury's request for information on dividend restriction as a new requirement that was added subsequent to the application process. These representatives noted that the requirement that participants be able to pay dividends was not explicitly communicated when the information on SBLF was first posted on SBLF's website in December 2010.³³ For example, it was not included in the initial guidance, the application form, or the question-and-answer section on the website. This program requirement was also not mentioned in Treasury's initial outreach efforts (e.g., webinars and conferences). Similarly, officials from FDIC, Federal Reserve, and OCC also told us that Treasury's decision to not fund banks with dividend restrictions had not been explicitly stated when the program was established in December 2010. In addition, the regulators noted that Treasury officials did not discuss this issue with them until early May 2011.

Treasury officials noted that the requirement was described in the program's published Summary of Preferred Terms posted on December 20, 2010, and was not a new eligibility criterion or policy change. Specifically, Treasury officials pointed out that the summary of terms stated that the main policy instrument for SBLF was the dividend rate, which would be an incentive for institutions to lend to small businesses

³²According to Treasury, they also tried to obtain dividend restriction information from the state regulators. However, state regulators did not consistently report this information, and certain states subsequently decided not to participate in the supervisory consultation process.

³³Treasury subsequently posted this information on its website in May 2011.

and repay SBLF funding within a certain time frame. Given the program's focus on the dividend rate, Treasury officials assumed that applicants would understand that they needed to be free of restrictions on paying dividends.

The confusion about the dividend restriction program requirement resulted in a number of banks unable to currently pay dividends applying for the program. Specifically, our analysis showed that 231 of the applicants had some form of dividend restrictions.³⁴ According to industry representatives we spoke with, if Treasury had communicated this requirement more clearly from the outset, banks might not have spent time and effort applying to the program or would have had more time to work with their regulators on lifting the restrictions to increase their chances of being accepted.

Status of Applications

Although approved institutions began receiving funds in June 2011, many applicants that were not selected to participate in SBLF were not told of their status until September 2011, almost 4 months after the application deadline. Treasury officials explained that by waiting to make final decisions for some applicants that would not receive approval on the basis of results from the first-quarter call reports, Treasury was able to consider results from the second-quarter call reports that contained data on the banks' financial conditions through June 2011.

When Treasury informed applicants of their status, it did not initially communicate why the banks were not approved. This lack of information created confusion and frustration among some applicants. For instance, representatives from one banking trade group told us that some members were confused about not being approved because they had high CAMELS composite ratings and no dividend restrictions and their respective regulators had informed them that they had received a positive viability determination. As we noted earlier, our analysis of Treasury's funding decisions found some applicants that fell within the established parameters but were not approved. Specifically, we found 85 applicants that were not approved by Treasury despite (1) receiving a positive viability determination, (2) having a CAMELS composite rating of 2, and (3) being able to pay dividends. Treasury officials told us that they did not

³⁴Fifty-three of these applicants would have been ineligible regardless of whether they had dividend restrictions because they did not meet the eligibility criteria established by the act by either being on FDIC's problem bank list or having more than \$10 billion in assets.

initially explain to the applicants as to why they were not approved because relevant supervisory information was confidential, and Treasury was prohibited by law from disclosing this information. However, according to OCC, they were also not initially consulted about Treasury's decision about what to communicate to applicants who were denied, and when such discussions did take place, OCC encouraged Treasury to provide explanations to applicants. In addition, FDIC and the Federal Reserve noted that the regulator's confidential information was only one input into Treasury's decision-making process, and the investment decisions were Treasury's, not the regulators. Nevertheless, Treasury's emphasis on the confidential supervisory information contributed to the delay in notifying applicants of the reasons for not being approved and reduced the transparency of the decisions. Treasury informed us that they have subsequently reached an agreement with the regulators to share more information on those decisions with the affected SBLF applicants and has finished contacting nonapproved applicants with additional information regarding its decision.

Treasury's ineffective communication about the dividend restriction program requirement, delays in communicating the status of applications, and lack of explanation for its nonapproval decisions resulted in confusion among applicants and may also have negatively affected how the potential pool of applicants and the public perceived the program. Federal government internal control standards state that management should ensure that the agency has adequate means of communicating with and obtaining information from external stakeholders when such information could have a significant impact on the agency's achieving its goals.³⁵ The experience and lessons from the first year implementing SBLF could be instructive to Treasury's communication strategy about the status of the program going forward. Without a more effective communication strategy that enhances understanding of the program's goals and requirements and recognizes the need for timely communication with external stakeholders, SBLF will continue to be poorly understood by the public and Congress.

³⁵GAO/AIMD-00-21.3.1.

Characteristics of Applicants and Participants and Factors Affecting SBLF Participation

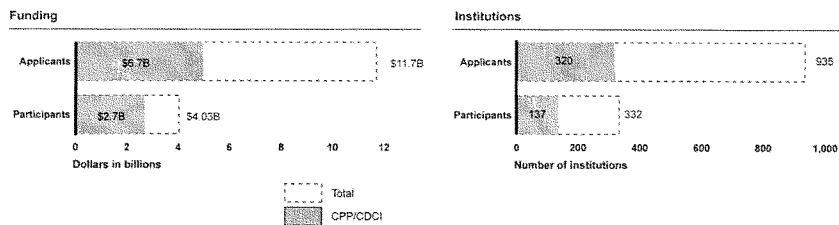
Fewer institutions applied to SBLF and received funding than initially anticipated. Although SBLF's authorizing legislation provided up to \$30 billion for investing, Treasury expected program participation to be lower and budgeted \$17.4 billion in SBLF investments in its fiscal year 2011 budget request, based on an internal analysis of projected program activity.³⁶ However, interest in SBLF was lower than Treasury anticipated, with 935 financial institutions applying to the program for a combined funding request of \$11.7 billion. Ultimately, 332 institutions received \$4.03 billion in SBLF investments. Of the 332 program participants, 281 (85 percent) were banks, while the remaining 51 institutions (15 percent) were CDLFs.

The program attracted smaller institutions including those seeking to refinance CPP and CDCI funds. Sixty-five percent (612) of SBLF applicants were small institutions with total assets of \$500 million or less, and 61 percent (204) of participants fall within this category.³⁷ In addition, about one-third (320) of the total number of applicants were seeking to refinance CPP and CDCI funds, and these applicants requested \$6.7 billion in funds—representing about 57 percent of the total dollar amount requested (see fig. 3). Treasury approved 137 of the applicants seeking to refinance CPP and CDCI funds, investing a total of \$2.7 billion in these institutions. This represented about 67 percent of all SBLF investments.

³⁶The \$17.4 billion figure was reported in Treasury's submission to the President's 2012 budget.

³⁷The amounts for total assets were obtained from the institutions' call reports and exclude CDLFs, which do not submit call reports and did not report total assets.

Figure 3: SBLF Applicant and Participant Data



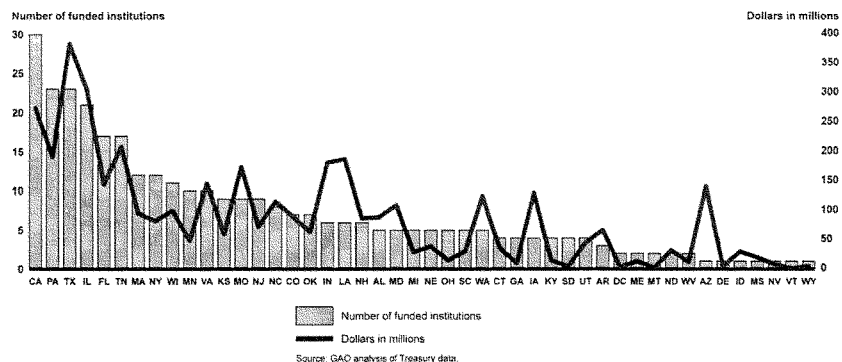
Source: GAO analysis of Treasury data.

Note: Of the \$6.7 billion in requested to refinance CPP and CDCI funds, \$5.69 billion was to repay CPP/CDCI principal. \$2.2 billion of the ultimate \$2.7 billion CPP/CDCI investments were for refinancing outstanding CPP and CDCI funds.

The program also attracted institutions from across the country. Figure 4 shows the geographic distribution of SBLF investments by number of institutions per state and SBLF dollars per state. The Small Business Jobs Act required the Secretary of Treasury to consider, among other factors, increasing opportunities for small business development in high unemployment areas—a consideration Treasury sought to address by focusing outreach activities in 10 states with the highest unemployment (as well as the District of Columbia), which included direct outbound calling efforts to eligible institutions in these states. We found that higher levels of state unemployment were not associated with greater SBLF funding in the state.³⁸

³⁸Statistically, the correlation between unemployment and the amount of funding (or the number of funded institutions) is indistinguishable from zero. More funding did tend to go to states with greater GDP, but there is no relationship between unemployment and the amount of funding even after controlling for state GDP. There is variation in unemployment rates within states, and our analysis at the state level does not account for this.

Figure 4: SBLF Investments by State



Note: Five states did not have institutions that received SBLF funds: Alaska, Hawaii, New Mexico, Oregon, and Rhode Island.

Comparison of SBLF Applicants and Banks to Non-SBLF Peer Banks

To better put the financial characteristics of SBLF applicant and participant banks in context and to describe the types of institutions that were attracted to and funded by SBLF, we generated a group of peer institutions that had not applied to SBLF and compared them with SBLF applicants and participants (funded banks), in addition to comparing SBLF participants with applicants that were not funded.³⁹ For example, SBLF participants had lower capital ratios and a smaller proportion of certain small business loans (as a percentage of total domestic business

³⁹We developed a peer group of institutions by matching each applicant with an institution in the same general category of institutions (e.g., thrifts) and in the same state. We did not assess banks' individual financial condition; rather, we looked at averages of certain indicators to make comparisons between the groups. In order to make the two groups more comparable, we also omitted problem banks from both applicants and peers when comparing these groups, as these institutions are ineligible for SBLF. We excluded CDLFs for the analysis of both applicants and peers. The lack of supervisory information for CDLFs did not enable us to describe comparable financial characteristics. For more information, see appendix I.

and farm loans) than the peer group. Participants also had higher asset quality than peers.

- *Capital ratios.* Both SBLF applicants and participants had less capital than their nonapplicant peers. The risk-based capital ratio—the ratio of total capital to risk-weighted assets—was about 15 percent for both SBLF applicants and participants, compared with roughly 19 percent for peers.⁴⁰
- *Small loan portfolio.* Both SBLF applicants and participants had a smaller proportion of certain small loans on their balance sheets—that is, loans of less than \$1 million for business and commercial real estate and less than \$500,000 for farms—than nonapplicants.⁴¹ For SBLF applicants small loans on average comprised 57 percent of loans, whereas participants had an average of 56 percent. For peer banks, the average was 62 percent.
- *Asset quality.* SBLF participants compared more favorably to applicants that were not funded and their peers in asset quality. Problem loans, a measure of asset quality, averaged 2.5 percent for SBLF participants compared with 5.7 percent for applicants that were not funded and 3.8 percent for peers.
- *CAMELS composite ratings.* On average, SBLF participants also had better CAMELS composite ratings than applicants that were not funded. SBLF banks averaged a CAMELS composite rating of 2.0, while applicants that were not funded averaged a CAMELS rating of 2.7, indicating some areas of supervisory concern. Nonapplicant peers had an average CAMELS composite rating of 2.1.⁴²

⁴⁰For risk-based capital ratios, the adequately capitalized minimum is 8 percent and is equivalent to internationally adopted Basel minimums that apply to both banks and bank holding companies.

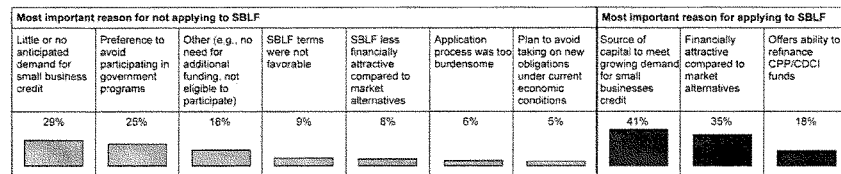
⁴¹This definition of small loans is based on regulatory submissions and is different from the SBLF definition, which defines qualified small business lending as loans below \$10 million to firms with revenue less than \$50 million annually. Regulatory submissions do not include information according to the SBLF definition of qualified small business lending.

⁴²The comparison of applicants to peer banks excludes problem banks. When we included problem banks in the applicant and peer groups, both had average CAMELS ratings of about 2.5.

Banks Frequently Cited Lack of Demand as the Most Important Reason for Not Applying to the Program

In our nationally representative survey of banks, about four-fifths responded that they did not apply or plan to apply to the SBLF program.⁴³ The most important reason cited for not applying to the SBLF program was little or no anticipated demand for small business credit followed closely by a preference not to participate in government programs, as shown in figure 5. The banks that did apply anticipated loan demand in their respective areas, but indicated that their most important reason for applying was because SBLF was a source of capital to meet a growing demand for small business credit (as shown in fig. 5). Other reasons for applying to SBLF were that the program's cost of capital was more attractive relative to market alternatives and that the program offered the option of refinancing CPP/CDCI funds.

Figure 5: Factors Affecting Banks' Participation in SBLF



Source: GAO survey results.

Note: The 95 percent confidence intervals around the estimates for not applying to the SBLF do not exceed plus or minus 5 percentage points. The 95 percent confidence intervals around the estimates for applying to the SBLF do not exceed plus or minus 12 percentage points.

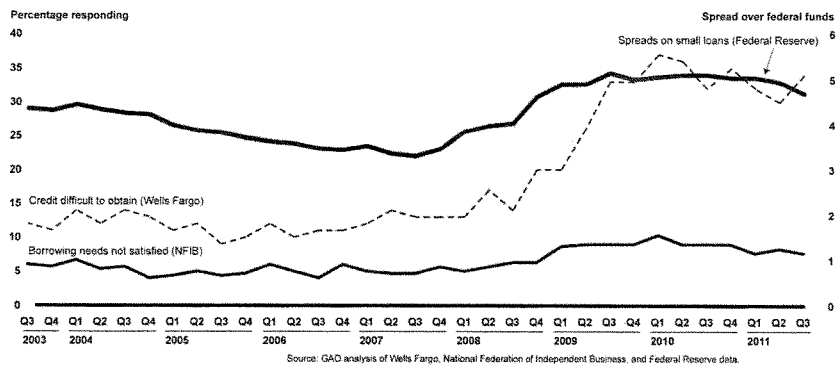
⁴³GAO conducted a nationally representative survey of 794 banks, thrifts, and bank and thrift holding companies with total assets of less than \$10 billion to gather information on their reasons for choosing to apply or not apply for SBLF. The final sample included 794 banks out of a total population of 6,733. 510 banks, or 64 percent, responded to the survey. The weighted response rate was 66 percent.

Treasury Has Not Finalized Plans to Monitor SBLF Participants or Track SBLF's Impact

Credit Conditions Remain Challenging for Small Businesses

The SBLF program was designed to improve small businesses' access to credit, which had become difficult to obtain since 2008. We examined trends in the credit markets from late 2003 through the third quarter of 2011 to document the credit market environment in which the program and its participants must operate. As shown in figure 6, from the second half of 2003 through early 2008, credit conditions were stable and credit was relatively easy to obtain. Credit became increasingly difficult to obtain (tight) from 2008 through 2009 in the midst of the financial crisis, and it peaked between mid-2009 and mid-2010. Credit availability has eased somewhat since its peak.

Figure 6: Indicators of Small Business Credit Conditions, Third Quarter 2003-Third Quarter 2011



Note: The indicators in the figure and the organizations that measure them are the following: (1) the National Federation of Independent Business, a small business trade association, surveys its members on whether or not their borrowing needs have been satisfied; (2) Wells Fargo conducts a survey of small business with a sample constructed by Gallup and Dun & Bradstreet; and (3) the Federal Reserve surveys banks on the price of credit for loans of various sizes.

Other indicators that we reviewed also demonstrate easier access to credit since the 2007-2009 financial crisis. According to a Federal Reserve survey of relatively large banks, more banks began easing than tightening standards for loans to small firms starting in the third quarter of 2010. Further, lending to small businesses began increasing in the second half of 2009, according to a measure of loan originations.⁴⁴ While credit availability has eased since 2009, movement in each indicator of small business lending has been volatile in the last few years, and small business credit remains tight relative to historical averages. However, a return to credit conditions of the boom years prior to the financial crisis would not necessarily be expected. Although small business credit conditions have improved since the 2007-2009 financial crisis, uncertainty about future credit conditions and the economic outlook increases the importance of monitoring SBLF participants going forward.

Treasury Has Not Finalized Plans for Monitoring SBLF Participants and the Program's Impact Because Focus Has Been on Implementation

Treasury has not finalized plans to monitor SBLF participants. Treasury officials acknowledged the need for ongoing analysis, monitoring, and reporting on SBLF participants, but at this time only has some procedures in place and preliminary plans for other procedures. These plans include potentially hiring outside firms to assist in managing the \$4.03 billion SBLF portfolio, using such firms to evaluate the financial data that SBLF institutions provide, and developing a system to detect inconsistent or inaccurate information that might be submitted in participants' quarterly supplemental reports. Treasury has taken some steps toward monitoring and reporting on SBLF participants. For example, in October 2011, Treasury began publishing, on its website, SBLF transaction reports that include dividend payment information. These reports include, among other things, all SBLF participants, the dividend payments expected and received, and total payments to date.

Similarly, Treasury has not finalized plans to assess the impact of the SBLF program. Treasury is required to provide a written report to

⁴⁴The Small Business Lending Index (SBLI) is a measure of new loans to small businesses developed by Thomson Reuters and PayNet Inc.

Congress on a quarterly basis that includes information about how participating institutions have used the SBLF funds they received. Treasury officials stated that their plans for assessing impact are still being developed. However, Treasury officials told us that they have some preliminary plans, including tracking the number of small business loans using data from SBLF participants' quarterly supplemental reports in order to gauge increased small business lending; conducting an annual survey of small business lending; and conducting a study on how women- and minority-owned small businesses have been impacted by the program. Treasury officials have also considered comparing SBLF banks and a non-SBLF bank peer group to identify any relationships between the program and small business lending. Officials noted that they are still considering various approaches for how to assess the program's impact, including how to collect and report needed data. In addition, Treasury officials acknowledged particular difficulties associated with linking SBLF to growth in employment, including how to account for the role of loans in keeping businesses operating that might otherwise have shut down, and how to treat loan refinancing.

Treasury officials told us that they have not finalized their plans for monitoring SBLF participants or assessing the impact of the program because they have been focused on implementing the program. As discussed, Treasury was evaluating applicants and making funding decisions through most of September. While Treasury officials said they recognize the importance of such assessments, they stated that they have not had sufficient time to devote to fully developing their plans.

Treasury faces a number of challenges as it moves forward in finalizing long-term plans to monitor SBLF participants and evaluate the SBLF program. First, Treasury will likely need to monitor SBLF participants without direct input from the federal regulators. According to Federal Reserve, OCC, and FDIC officials, there are currently no plans to coordinate with Treasury in monitoring SBLF banks. Regulators noted that their role, as defined by the statute, was to provide input to Treasury about the banks' financial viability during the application process. The statute does not give the regulators a role in monitoring SBLF banks, and regulators stated that SBLF banks will not be treated differently or have their own set of exam procedures during their supervisory examinations. One agency noted that they will review bank lending practices as part of the regular examination process. Second, the relationship between small business lending and job growth is complex, and making conclusions about the impact of the program on employment based on lending at SBLF banks will not be straightforward. Third, while using a control group

to assess performance is a best practice, any assessment could be complicated by the fact the SBLF banks will report their small business lending in a way that is inconsistent with call reports of non-SBLF banks (the peer group). For example, as noted earlier, SBLF considers small loans to be those under \$10 million, whereas the call reports collect data on loans under \$1 million (or under \$500,000 in the case of farm-related loans). Without comparable data for peers, measuring the impact it of SBLF on small business credit availability will be difficult.

Internal control standards for the federal government state that internal control activities are a major part of efficiently and effectively managing a program.⁴⁵ Control activities, such as (1) proper execution of transactions and events, (2) accurate and timely recording of transactions and events, (3) and establishing and reviewing performance measures, are an integral part of an agency's planning, implementing, reviewing, and accountability for stewardship of government resources and achieving effective results. Establishing performance measures and developing a process for monitoring participating financial institutions will be critical to identifying and addressing any potential problems in these institutions' compliance with program requirements.⁴⁶ Until Treasury finalizes its plans for monitoring compliance and assessing impact in a timely manner, it will not be positioned to anticipate and manage payment problems and other program risks. For example, if the macroeconomic conditions deteriorate, SBLF participants may not have as many opportunities to lend to small businesses as originally planned, and participants may be obliged to pay a higher dividend rate than they originally anticipated. Participants may also need to preserve their capital and thus may be unable to pay dividends or their respective regulators may restrict their ability to do so if their condition warrants such a restriction, for example, if economic conditions deteriorate sufficiently. Furthermore, SBLF participants may loosen their underwriting standards to meet higher lending targets, a concern shared by OCC. Such factors will also need to be considered as Treasury develops its plans for monitoring and assessing the impact of

⁴⁵GAO/AIMD-00-21.3.1.

⁴⁶Once risks have been identified, they should be analyzed for their possible effect. Risk analysis generally includes estimating the risk's significance, assessing the likelihood of its occurrence, and deciding how to manage the risk and what actions should be taken. Because governmental, economic, industry, regulatory, and operating conditions continually change, mechanisms should be provided to identify and deal with any special risks prompted by such changes.

the SBLF program. Until Treasury's plans are finalized and implemented, it will not be able to provide information on the effectiveness of the SBLF program.⁴⁷

Conclusions

Intended to improve the flow of credit to small businesses, the SBLF program attracted fewer banks and community development loan funds than expected and encountered significant delays in providing funding. Instances of poor communication during the first year of the SBLF program created confusion among applicants. Although Treasury conducted numerous outreach efforts to inform potential applicants and the public about the program, some communications were incomplete or unclear. Specifically, Treasury did not initially make clear that participants would have to be free of restrictions on paying dividends, and more than 200 applicants that could not make such payments applied to the program without knowing that they would not meet program requirements. Moreover, Treasury did not explain to applicants its reasons for not accepting them in the SBLF program, and many of these applicants did not find out that they had not been approved until months after applying. Treasury later took steps to improve communications by working with the bank regulators to determine how to communicate to banks the reasons for not being approved. However, the experience of SBLF applicants highlights the importance of timely, transparent communications throughout the program implementation process, a lesson that will continue to be important going forward.

SBLF's impact on small business lending will be difficult to measure, both because Treasury has yet to finalize evaluation plans and because multiple factors affect lending trends. Treasury has not fully developed procedures to monitor participants for compliance with the program's requirements or measures to assess SBLF's effectiveness in increasing small business lending. Establishing procedures is an important component of accountability for stewardship of government resources. As we found in reviewing Treasury's application evaluation process, procedures also may need to adapt to changing circumstances, and such adjustments should be clearly documented. Monitoring compliance,

⁴⁷In prior reports, we have reported that internal controls are a major part of efficiently and effectively managing a program, and developing a process for monitoring participating financial institutions will be critical to identifying and addressing any potential problems in these institutions' compliance with program requirements.

including compliance with program terms such as dividend payments, and taking steps to ensure that the data participants provide on their small business lending are accurate, is important going forward. In addition, the reports on small business lending will be an important component of measuring the effectiveness of SBLF. Efforts to measure SBLF's impact will be difficult because many factors affect trends in small business and other lending. In addition, limited participation in the program highlights the challenge of balancing the need to protect taxpayer interests with the desire to distribute SBLF funds to struggling areas of the economy. Treasury's efforts to consider approaches for isolating the impact of SBLF will be critical to providing a rigorous assessment of whether the program is effective. While Treasury officials said that they had been unable to complete plans to monitor compliance and assess SBLF's impact on small business lending during the application and initial disbursement process, now is the time for Treasury to finalize its plans for monitoring compliance and assessing SBLF. Without a thorough assessment of the SBLF program's performance, Congress and other policymakers will lack important information about the effectiveness of capital infusion programs for increasing small business lending.

Recommendations for Executive Action

While Treasury took steps to evaluate SBLF applicants in a consistent manner and provide information about the program through numerous outreach efforts, we recommend that the Secretary of the Treasury take the following three additional actions going forward:

- To promote transparency and improve communication with SBLF participants and other interested stakeholders, such as Congress and the bank regulators, Treasury should apply lessons learned from the application review phase of SBLF to help improve its communication strategy going forward.
- To enhance the transparency and accountability of the SBLF program, Treasury should finalize (1) procedures for monitoring participants, including procedures to ensure that Treasury is receiving accurate information on participants' small business lending and (2) plans for assessing the performance of the SBLF program, including measures that can isolate the impact of SBLF from other factors that affect small business lending.

Agency Comments and Our Evaluation

We provided a draft of this report to Treasury, FDIC, Federal Reserve, and OCC for review and comment. Treasury provided written comments, which are reprinted in appendix III. In its comments, Treasury agreed with our three recommendations and stated it is taking steps to incorporate these recommendations into existing plans and procedures to further support transparency and accountability. Treasury noted that it has worked to achieve a high level of transparency and accountability throughout the implementation of the SBLF program. For example, Treasury stated that it had conducted extensive outreach with potential applicants, including participating in industry events, teleconferences, and webinars. Treasury also provided technical comments, which we incorporated as appropriate. In addition, FDIC, Federal Reserve, and OCC provided technical comments, which we incorporated as appropriate.

We are sending copies of this report to the appropriate congressional committees, Treasury, FDIC, Federal Reserve, and OCC. The report also is available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staff members have any questions about this report, please contact A. Nicole Clowers at (202) 512-8678 or clowersa@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix IV.



A. Nicole Clowers
Director
Financial Markets and Community Investment

List of Committees

The Honorable Debbie Stabenow
Chairwoman
The Honorable Pat Roberts
Ranking Member
Committee on Agriculture, Nutrition and Forestry
United States Senate

The Honorable Daniel K. Inouye
Chairman
The Honorable Thad Cochran
Vice Chairman
Committee on Appropriations
United States Senate

The Honorable Tim Johnson
Chairman
The Honorable Richard C. Shelby
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Kent Conrad
Chairman
The Honorable Jeff Sessions
Ranking Member
Committee on the Budget
United States Senate

The Honorable Max Baucus
Chairman
The Honorable Orrin G. Hatch
Ranking Member
Committee on Finance
United States Senate

The Honorable Mary L. Landrieu
Chairman
The Honorable Olympia J. Snowe
Ranking Member
Committee on Small Business and Entrepreneurship
United States Senate

The Honorable Frank D. Lucas
Chairman
The Honorable Collin Peterson
Ranking Member
Committee on Agriculture
House of Representatives

The Honorable Hal Rogers
Chairman
The Honorable Norm Dicks
Ranking Member
Committee on Appropriations
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The Honorable Paul Ryan
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The Honorable Chris Van Hollen
Ranking Member
Committee on the Budget
House of Representatives

The Honorable Spencer Bachus
Chairman
The Honorable Barney Frank
Ranking Member
Committee on Financial Services
House of Representatives

The Honorable Sam Graves
Chairman
The Honorable Nydia Velazquez
Ranking Member
Committee on Small Business
House of Representatives

The Honorable Dave Camp
Chairman
The Honorable Sander Levin
Ranking Member
Committee on Ways and Means
House of Representative

Appendix I: Objectives, Scope, and Methodology

The objectives of our report were to examine (1) the procedures that the Department of the Treasury (Treasury) developed to implement SBLF and evaluate applications for Small Business Lending Fund (SBLF) funds; (2) the characteristics of institutions applying to and receiving SBLF funds and the factors that may have influenced banks' decision to participate; and (3) Treasury's plans to monitor SBLF participants and measure the SBLF's progress in increasing small business lending.

To assess Treasury's evaluation process for SBLF applications, we reviewed Treasury's policies, procedures, and internal controls for SBLF, including nonpublic documents, such as the Treasury's internal control procedures and Application Review Committee and Investment Committee minutes, and publicly available material from the SBLF website. We reviewed Treasury's and the four federal regulators' respective roles and responsibilities with respect to evaluating applicants and compared them with the same roles for the Capital Purchase Program (CPP), a capital infusion program under the Troubled Asset Relief Program (TARP) that is similar to SBLF. We interviewed officials from Treasury, Federal Deposit Insurance Corporation (FDIC), Board of Governors of the Federal Reserve System (Federal Reserve), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS) to obtain information on their SBLF applicant evaluation processes and to discuss the similarities and differences between SBLF and CPP in terms of their roles and the processes for evaluating applicants. We also interviewed representatives of industry trade groups, including American Bankers' Association, International Franchise Association National Federation of Independent Business, Independent Community Bankers Association, and the National Association of Government Guaranteed Lenders to obtain their perspectives on SBLF and the application process.

To identify applicants that fell outside of Treasury's stated evaluation parameters, we obtained data from Treasury, FDIC and SNL Financial (SNL) for all applicants on key inputs that Treasury used to inform its funding decisions, including CAMELS composite ratings, repayment probability, performance ratios, lending plan scores, dividend restriction information, and results of regulators' financial viability assessments. To assess the reliability of Treasury's data, we (1) performed electronic checking for errors in accuracy and completeness; (2) reviewed related documentation, such as minutes from the Application Review Committee and Investment Committee; and (3) held numerous meetings and remained in ongoing correspondence with Treasury to discuss data fields, analysis procedures, and weekly data updates. When we found

inconsistencies, for example, between the weekly data updates or between the data and published information, we clarified them with Treasury. For example, during our interviews with Treasury, we learned that 60 applicants were approved by Treasury but did not close and were labeled in the same category ("withdrawn") as applicants that were not approved. After clarifying and resolving our questions pertaining to the data, we concluded that the updated data set was reliable for the purpose of identifying applicants that fell outside of Treasury's stated evaluation parameters.

Using this updated and corrected data set, we performed an analysis for all 935 applicants to identify which of the applicants, both approved and nonapproved, fell out of Treasury's stated evaluation parameters (Table 1 lists the key data that Treasury used to inform its funding decisions and their corresponding parameters). We compared all data fields pertaining to Treasury's stated evaluation parameters, such as the regulator's viability assessment, repayment probability estimates, and lending plan results to Treasury's decision data field to identify those applicants outside of the parameters. We did not review the evaluation documents, such as regulator's supervisory consultation memos and minutes from the Application Review and Investment Committees for all 935 applicants.

Table 1: Main Parameters Treasury Used for Evaluating SBLF Applicants

Key Data	Parameters
Eligibility	Treasury determined only all approved applicants must first pass the initial eligibility check .
Positive financial viability	Treasury determined only all approved applicants must first receive a positive financial viability assessment from their respective regulators.
CAMELS composite ratings ^a	Treasury considered CAMELS composite ratings of 1, 2 or 3 as acceptable. Per the legislation, problem banks (i.e., banks with CAMELS composite ratings of 4 and 5) were not eligible.
Repayment probability estimate	Treasury determined that repayment probability of 80 percent as the minimum acceptable. An initial estimate was developed by financial agents. Treasury reviewed this initial estimate and, if needed, updated the estimate to incorporate confidential supervisory information.
Key performance ratios	Treasury considers the following as thresholds that would require further review: <ul style="list-style-type: none"> <i>Classified assets ratio</i>: Classified assets/Net Tier 1 capital + allowance for loan and lease losses (ALLL): greater than 100 percent^b <i>Nonperforming loans ratio</i>: Nonperforming loans (NPLS) + other real estate owned (OREO) /Net Tier 1 capital + ALLL: greater than 40 percent <i>Construction and development loans</i>: Construction and development loans/Total risk-based capital: greater than 300 percent^c

Appendix I: Objectives, Scope, and Methodology

Key Data	Parameters
Lending plan scores	Treasury evaluated the lending plans as either responsive or nonresponsive. Treasury rated applicants' lending plan based on a 12 point evaluation. Any applicants that received 8 points or above, their lending plans were deemed responsive. The ones that received 7 points or below were deemed nonresponsive.
Dividend restrictions	Treasury determined only applicants that are able to pay dividends to SBLF funds could be approved.

Source: GAO summary of Treasury documentation.

^aThis exclude CDLFs, because CDLFs do not face the same regulatory reporting requirements as banks and thus do not have supervisory data.

^bTier 1 capital is considered the most stable and readily available capital for supporting a bank's operations. It covers core capital elements, such as common stockholder's equity and noncumulative perpetual preferred stock.

^cClassified assets are known only by the regulators, so the financial agents would not be able to do this in the absence of the supervisory consultation memos. The "allowance for loan and lease losses" (ALLL) is an account maintained by financial institutions to cover incurred losses in their loan and lease portfolios. The "other real estate owned" (OREO) is an account used for examination and reporting purposes that primarily includes real estate owned by a financial institution as a result of foreclosure.

Using the results from this analysis, we then selected a small, nongeneralizable sample of 15 applicants that appeared to be particularly out of line with Treasury's stated parameters for additional review. In selecting the sample, we attempted to identify at least 3 applicants from each of the following categories:

- 6 approved outliers that had a repayment probability of less than 63 percent
- 3 nonapproved applicants that had a repayment probability of greater than 95 percent
- 3 approved outliers that had nonperforming loan ratios of greater than 55 percent
- 3 nonapproved applicants that had a no nonperforming loans

Because our findings are based on a nongeneralizable sample, they cannot be generalized to all applicants. However, because they represent significant deviations from Treasury's stated evaluation parameters, our analysis provides useful examples of how Treasury used these inputs in making funding decisions. As part of this analysis, we reviewed minutes from the Application Review Committee and Investment Committee, and interviewed Treasury officials. Our criteria for assessing Treasury's

evaluation process drew from GAO's *Standards for Internal Control in the Federal Government* and past GAO work, particularly on CPP.¹

To describe the characteristics of institutions that applied for and received SBLF program funds, we collected and analyzed data from Treasury. For example, we analyzed the number of institutions that applied; the number of institutions that were approved and nonapproved; the number of institutions that applied to refinance CPP or CDCI funds; and the institutions' geographic locations. To determine the extent to which the distribution of SBLF funds was associated with state unemployment rates, we collected state unemployment rates from the Bureau of Labor Statistics and compared the data against both the number of funded institutions and the dollars of funding by state, using correlations and regression analysis.

We developed a comparable peer group of banks that did not receive SBLF program funds and compared their financial condition and recent small business lending with that of SBLF bank applicants and participants. We analyzed the proportion of loans worth less than \$1 million (or less than \$500,000 in the case of farm-related loans) as an indicator of one kind of small business lending. This definition is different from qualified small business lending under SBLF, which includes loans for under \$10 million to firms with revenue less than \$50 million. Peers were chosen based on size, geographic location, and type of institution. We excluded CDLFs from the analysis comparing applicants and participants with peers. These are not regulated depository institutions, and the lack of supervisory information did not enable us to describe comparable financial characteristics. For certain comparisons of applicants with peers, we omitted problem banks that were ineligible for SBLF so that the two groups would be more comparable. We obtained CAMELS composite ratings from FDIC for both applicants and peers. We assessed the reliability of the data used for our analyses by, for example, reviewing prior GAO work and inspecting data for missing observations and outliers. We found that they were sufficiently reliable to describe the characteristics of SBLF banks and their peers.

To determine banks' reasons for applying or choosing not to apply to the SBLF program, we conducted a nationally representative survey of

¹ GAO/AIMD-00-21.3.1.

executives of banking institutions with less than \$10 billion in total assets.² Based on lists of financial institutions provided by FDIC, OTS, and the Federal Reserve, we identified 6,733 institutions with less than \$10 billion in total assets to be included in our population for this survey. We selected a stratified random sample of 794 institutions from the population of 6,733 (see table 2). We stratified the population into four strata based on the amount of assets and whether the entity was part of a holding company or a stand alone bank or thrift. The sample size was determined to produce a proportion estimate within each stratum that would achieve a precision of plus or minus 7 percentage points or less, at the 95 percent confidence level. We then inflated the sample size for an expected response rate of 50 percent. Because of the smaller number of banks and holding companies with assets greater than \$5 billion and less than \$10 billion, we selected all of these with certainty.

We received valid responses from 510 (64 percent) out of the 794 sampled banking institutions. The weighted response rate, which accounts for the differential sampling fractions within strata, is 66 percent. We identified eight banking institutions in our sample that were either closed or were improperly included in the sampling frame. We classified these as out of scope institutions and adjusted our estimates so they are generalized only to the 6,659 (+/- 58) institutions estimated to be in-scope institutions in the population.

Table 2: Population, Sample Size, and Respondent Information for GAO Survey

Stratum	Population size	Sample size	Out of scope	Respondents within scope
Holding company \$5-\$10 billion	63	63	2	30
Holding company Less than \$5 billion	5,118	378	5	249
Banks \$5-\$10 billion	5	5	0	4
Banks less than \$5 billion	1,547	348	1	219
Total	6,733	794	8	502

Source: GAO survey results.

²Banking institutions includes banks, thrifts, and bank and thrift holding companies.

The Web-based survey was administered from June 15, 2011 to August 15, 2011. Bank executives were sent an e-mail invitation to complete the survey on a GAO Web server using a unique username and password. Nonrespondents received several reminder e-mails and a letter from GAO to complete the survey. The practical difficulties of conducting any survey may introduce additional nonsampling errors, such as difficulties interpreting a particular question, which can introduce unwanted variability into the survey results. We took steps to minimize nonsampling errors by pretesting the questionnaire with four banks in April 2011. We conducted pretests to make sure that the questions were clear and unbiased and that the questionnaire did not place an undue burden on respondents. An independent reviewer within GAO also reviewed a draft of the questionnaire prior to its administration. We made appropriate revisions to the content and format of the questionnaire after the pretests and independent review. All data analysis programs were independently verified for accuracy.

To assess Treasury's plans to monitor participants and measure SBLF's effectiveness, we interviewed Treasury officials about their intended work. To describe trends in small business credit markets, we used a number of indicators to describe market conditions before and during the implementation of SBLF. These indicators included data from a survey conducted by the National Federation of Independent Business on whether members' borrowing needs are being satisfied; a survey by Wells Fargo addressing banks' ease or difficulty in obtaining credit; and the Federal Reserve's bank survey on the cost of credit for loans of various sizes. For additional information on current credit market conditions, we also used data from a Federal Reserve's survey of large banks (Senior Loan Officer Opinion Survey) and an estimate of small business loan originations developed by Thomson Reuters and PayNet. To determine the reliability of these data sources, we relied on previous GAO work and interviewed company representatives as appropriate to learn about their data collection methods and any changes to their controls. Based on our analysis we determined that, while the individual sources were not independently crucial to our findings, they were sufficiently reliable together to document patterns in the small business credit markets.

We conducted this performance audit from December 2010 to December 2011 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Responses to Questions from GAO's Survey on the SBLF Program

We distributed a Web-based survey to 794 banking institutions from the population of 6,733 to determine whether they applied to the SBLF program and the reasons for their decision.¹ We received valid responses from 510 (64 percent) out of the 794 sampled institutions. Tables 3-7 below show the responses to questions from the survey. Because we followed a probability procedure based on random selections, our sample is only one of a large number of samples that we might have drawn. Because each sample could have provided different estimates, we also provide the lower and upper bound estimates at a 95 percent confidence interval. The weighted response rate, which accounts for the differential sampling fractions within strata, is 66 percent. For more information about our methodology for designing and distributing the survey, see appendix I.

Table 3: Has your bank applied, or does it plan to apply, to the SBLF program?

Responses	Estimated percentage	95 percent confidence interval-lower bound	95 percent confidence interval-upper bound
Yes, we applied.	18	14	22
Yes, we plan to apply.	2	<1	3
No	80	77	84

Source: GAO survey results.

Table 4: What are the reasons your bank had for applying for funding through the SBLF program?

Responses		%	95 percent confidence interval-lower bound	95 percent confidence interval-upper bound
It is a source of capital to meet growing demand for small business credit.	A reason	94	86	98
	Not a reason	6	2	14
It is financially attractive in relation to the expected cost of capital relative to market alternatives.	A reason	91	81	97

¹Banking institutions includes banks, thrifts, and bank and thrift holding companies.

Appendix II: Responses to Questions from
GAO's Survey on the SBLF Program

Responses	%	95 percent confidence interval-lower bound	95 percent confidence interval- upper bound
Not a reason	9	3	19
It offers the ability to refinance Capital Purchase Program (CPP) funds through the SBLF program.	A reason	31	20
	Not a reason	69	57
Other		18	68
		32	82

Source: GAO survey results.

Note: Examples of "Other" responses included the program offering a source of capital to grow and Tier 1 capital treatment.

Table 5: Of all the reasons your bank had for applying for funding through the SBLF program, which one was the most important reason for applying?

Responses	%	95 percent confidence interval-lower bound	95 percent confidence interval-upper bound
It is a source of capital to meet growing demand for small business credit.	41	29	52
It is financially attractive in relation to the expected cost of capital relative to market alternatives.	35	23	46
It offers the ability to refinance Capital Purchase Program (CPP) funds through the SBLF program.	18	9	29
Other	7	2	16

Source: GAO survey results.

Note: Examples of "Other" responses included the program offering a source of capital to grow and Tier 1 capital treatment.

Appendix II: Responses to Questions from
GAO's Survey on the SBLF Program

Table 6: What are the reasons your bank had for NOT applying for funding through the SBLF program?

Responses		%	95 percent confidence interval-lower bound	95 percent confidence interval-upper bound
We have little or no anticipated demand for small business credit.	A reason	42	36	47
	Not a reason	58	53	64
We plan to avoid taking on new obligations during current economic conditions.	A reason	22	17	26
	Not a reason	78	74	83
We prefer to avoid participation in government programs.	A reason	50	44	55
	Not a reason	50	45	56
The SBLF was less financially attractive in relation to the expected cost of capital relative to market alternatives.	A reason	28	23	34
	Not a reason	72	66	77
The terms of participation were unfavorable.	Not a reason	36	30	41
	Not a reason	64	59	70
The application process was too burdensome.	A reason	32	27	37
	Not a reason	68	63	73
Other	A Reason	38	30	47
	Not a reason	62	53	70

Source: GAO survey results.

Note: Examples of "Other" responses included not being eligible to apply for the program or not needing additional capital at the time.

Appendix II: Responses to Questions from
GAO's Survey on the SBLF Program

Table 7: Of all the reasons your bank had for NOT applying for funding through the SBLF program, which one was the most important reason for NOT applying?

Responses	%	95 percent confidence interval-lower bound	95 percent confidence interval-upper bound
We have little or no anticipated demand for small business credit.	29	24	34
We plan to avoid taking on new obligations during current economic conditions.	5	3	7
We prefer to avoid participation in government programs.	25	20	30
The SBLF was less financially attractive in relation to the expected cost of capital relative to market alternatives.	8	5	11
The terms of participation were unfavorable.	9	6	13
The application process was too burdensome.	6	4	9
Other	18	14	22

Source: GAO survey results.

Note: Examples of "Other" responses included not being eligible to apply for the program or not needing additional capital at the time.

Appendix III: Comments from the Department of the Treasury



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

December 1, 2011

A. Nicole Clowers
Director, Financial Markets and Community Investment
U.S. Government Accountability Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Ms. Clowers:

Thank you for the opportunity to review and comment on the GAO's draft report regarding the Small Business Lending Fund ("SBLF"). We appreciate your staff's collaborative approach in evaluating this initiative over a 13-month period that encompassed much of the program's design and implementation.

The Department of the Treasury ("Treasury") welcomes the GAO's conclusion that "Treasury adopted procedures to help ensure that applicants were evaluated consistently and were likely to repay funds," as these objectives were central elements of the program's design.

Throughout the implementation of the SBLF program, Treasury has worked to achieve a high level of transparency and accountability. Treasury engaged in extensive outreach with potential applicants, participating in over 50 industry events, teleconferences, and webinars as well as initiating more than 4,600 outbound calls directly to institutions. To date, Treasury has also published 15 program and transaction reports, including an initial assessment of increases in small business lending among SBLF participants and a detailed study of the program's potential impact on lending to women-, veteran-, and minority-owned small businesses.

Treasury agrees with the GAO's three recommendations – each of which is aimed at furthering the objectives of transparency and accountability – and is taking steps to incorporate these recommendations into our existing plans and procedures.

In closing, we appreciate the constructive relationship we have developed with you and your team. We look forward to continuing to work together on this important program.

Sincerely,

Don Graves, Jr.
Deputy Assistant Secretary for Small Business,
Community Development, and Affordable
Housing Policy

Appendix IV: GAO Contact and Staff Acknowledgments

GAO Contact

A. Nicole Clowers, (202) 512-8678, or Clowersa@gao.gov

Staff Acknowledgments

In addition to the contact above, Kay Kuhlman, Assistant Director; Tania Calhoun; Emily Chalmers; Pamela Davidson; Colin Gray; Simin Ho; Michael Hoffman; Jonathan Kucskar; and Angela Messenger made key contributions to this report.

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GAO

United States Government Accountability Office

Report to Congressional Committees

December 2012

SMALL BUSINESS LENDING

Opportunities Exist to Improve Performance Reporting of Treasury's Programs



G A O

Accountability • Integrity • Reliability

GAO-13-76



Highlights of GAO-13-76, a report to congressional committees

December 2012

SMALL BUSINESS LENDING

Opportunities Exist to Improve Performance Reporting of Treasury's Programs

Why GAO Did This Study

The Small Business Jobs Act of 2010 aimed to stimulate job growth by, among other things, establishing the SBLF and SSBCI programs within Treasury. SBLF uses capital investments to encourage community banks with assets of less than \$10 billion to increase their small business lending. SSBCI provides funding to strengthen state and municipal programs that support lending to small businesses. Under the act, GAO is required to conduct an audit of both programs annually. GAO's first reports were on the programs' implementation and made recommendations. This second report examines (1) the status of Treasury's efforts to monitor participants' compliance with program requirements under SBLF and SSBCI, (2) the status of SBLF's and SSBCI's small business lending, and (3) Treasury's evaluation of SBLF and SSBCI and communication of outcomes to Congress and interested parties. GAO reviewed Treasury documents on SBLF and SSBCI procedures; analyzed the most recent available performance information for both programs and data on financial institutions; and interviewed officials from Treasury and nine states participating in SSBCI.

What GAO Recommends

Treasury should develop a policy on how it will use its authority to terminate SSBCI funds. Treasury should also expand its methodology discussion in SBLF reports and make the results of SSBCI performance measures public. In written comments on a draft of this report, Treasury agreed to implement these recommendations.

View GAO-13-76. For more information, contact Daniel Garcia-Diaz (202) 512-8678 or garciafd@ga.gov.

What GAO Found

The U.S. Department of the Treasury (Treasury) has made progress in developing guidance and procedures to monitor participants' compliance with requirements for the Small Business Lending Fund (SBLF) and the State Small Business Credit Initiative (SSBCI) programs. In response to GAO's previous recommendation on SBLF monitoring, Treasury has developed procedures for monitoring SBLF participant compliance with legal and reporting requirements. Treasury also issued standards to provide states with best practices for reviewing participants' compliance with SSBCI's legal and policy requirements and developed procedures for sampling transaction-level data to evaluate the accuracy of the states' SSBCI annual reports.

As of June 30, 2012, SBLF participants had increased their business lending over the 2010 baseline. The median SBLF participant had a 31 percent increase in total business lending and a 14 percent increase for small business loans under \$1 million, according to GAO's analysis. For SSBCI, states had used about 10 percent of the funds as of June 30, 2012. The act provides Treasury with authority to terminate funds that have not been allocated to states within 2 years of Treasury's approval of the state's participation in SSBCI. However, Treasury has not yet developed a formal written policy explaining what actions it will take if SSBCI participants have not met the requirements to receive their full allocation of funds within the 2-year time frame. Treasury officials said that they currently have no plans to use this authority but retain the ability to do so in the future. Nevertheless, formal guidelines on how Treasury will use this authority could help ensure consistent use of the authority if used in the future and provide clarity to states about the consequences of not using the funds in a timely manner.

Treasury has taken steps to evaluate SBLF's and SSBCI's performance but could enhance public reporting of program outcome information. In a quarterly report to Congress, Treasury compares business lending in SBLF participants to a large comparison group that it adjusted for certain aspects of bank size and geography. GAO's analysis using a peer group that was adjusted for financial health as well geography and size showed that in nearly every case, the difference in total business lending growth was somewhat smaller than in Treasury's analysis. Treasury considered using a more refined peer group that adjusted for these factors but judged that the differences were not significant. However, Treasury did not disclose these options in the report or explain why the larger comparison group was chosen, which compromised the transparency of Treasury's methodology. Furthermore, Treasury's approach did not isolate the impact of SBLF from other factors that could affect lending, as GAO recommended in its first SBLF report. Treasury officials said they are continuing to explore evaluation approaches, including collecting additional data from a survey of SBLF institutions. In response to GAO's 2011 recommendation on SSBCI performance measures, Treasury has designed performance measures, such as the amount of private leverage states have achieved with SSBCI funds. However, Treasury has not yet developed a way to make this performance information public. Treasury shares information with the states through conferences and technical assistance, but performance information could help Congress and the states to better understand the effectiveness of SSBCI's various programs.

United States Government Accountability Office

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Abbreviations

CAMELS	capital adequacy, asset quality, management, earnings, liquidity, and sensitivity to market risk
CAP	capital access programs
CDFI	community development financial institution
CDLF	community development loan funds
CPP	Capital Purchase Program
FDIC	Federal Deposit Insurance Corporation
GPRAMA	Government Performance and Results Act Modernization Act
OCSP	other credit support programs
OIG	Office of Inspector General (Treasury)
SBLF	Small Business Lending Fund
SSBCI	State Small Business Credit Initiative
TARP	Troubled Asset Relief Program

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United States Government Accountability Office
Washington, DC 20548

December 5, 2012

Congressional Committees

Small businesses play a vital role in the U.S. economy, accounting for about half of private-sector output and employing more than half of private-sector workers. Congressional interest in assisting small businesses has increased in recent years, primarily because of continued concerns about unemployment and the sustainability of the current economic recovery. In 2008 and early 2009, major disruptions of business credit markets made accessing credit difficult for small businesses. Currently, there is still concern that small businesses might not be able to access enough capital to create jobs. Recent data show that net employment growth at small businesses is not increasing at the same rate as in previous economic recoveries.

To address these concerns, Congress passed the Small Business Jobs Act of 2010, which was signed by the President on September 27, 2010.¹ Among other things, this legislation aims to stimulate job growth by establishing the Small Business Lending Fund (SBLF) and the State Small Business Credit Initiative (SSBCI). The SBLF program is designed to encourage banks and community development loan funds (CDLF) with assets of less than \$10 billion to increase their lending to small businesses with up to \$50 million in annual revenues.² The act authorized the Secretary of the Treasury to make up to \$30 billion of capital available and offered incentives to increase small business lending. However, interest in SBLF was lower than anticipated, with 935 financial institutions applying to the program for a combined funding request of \$11.7 billion. By September 2011, the Department of the Treasury (Treasury) had ultimately approved \$4.0 billion for 332 institutions through Treasury purchases of preferred stock or debt instruments—\$3.9 billion to 281 banks and \$104 million to 51 CDLFs. No additional SBLF funds will be awarded to banks or CDLFs.

¹Pub. L. No. 111-240, 124 Stat. 2504 (2010).

²In this report, "banks" refers to banks, thrifts, and bank and thrift holding companies. For purposes of the SBLF program, a CDLF is an entity that is certified by Treasury as a community development financial institution (CDFI) loan fund. A CDFI is a specialized financial institution that works in market niches that are underserved by traditional financial institutions.

Funded with \$1.5 billion, SSBCI is designed to strengthen state programs that support private financing to small businesses and small manufacturers that, according to Treasury, are not obtaining the loans or investments they need to expand and to create jobs. States are expected to use their SSBCI funds to leverage private financing and investment that is at least ten times the amount of their SSBCI funds (a leverage ratio of 10:1) by December 31, 2016. Forty-seven states, American Samoa; the District of Columbia; Guam; the Northern Mariana Islands; Puerto Rico; the U.S. Virgin Islands; Carrington, North Dakota; Mandan, North Dakota; and Anchorage, Alaska currently participate in the program.³

The 2010 Small Business Jobs Act requires us to conduct an annual audit of the SBLF and SSBCI programs.⁴ In our first reports, we reviewed the implementation of SBLF and SSBCI and made recommendations to improve the management oversight of the programs.⁵ This second report examines (1) the status of Treasury's efforts to monitor participants' compliance with program requirements under SBLF and SSBCI; (2) the status of SBLF and SSBCI participants' small business lending; and (3) the extent to which Treasury evaluates the SBLF and SSBCI programs and communicates their outcomes, such as an increase in small business lending, to Congress and interested parties.

To examine the status of Treasury's efforts to monitor participants' compliance with program requirements under SBLF and SSBCI, we analyzed Treasury's documentation and interviewed relevant officials. For SBLF, we reviewed and analyzed Treasury's compliance procedures. We interviewed Treasury officials on the process by which staff review the Quarterly Supplemental Reports for accuracy. For SSBCI, we reviewed *SSBCI National Standards for Compliance and Oversight* and SSBCI Policy Guidelines. We interviewed Treasury officials on implementing the

³North Dakota and Wyoming did not submit an SSBCI application. Alaska initially applied for its maximum SSBCI allocation before the June 27, 2011, deadline but subsequently withdrew its application. SSBCI also accepted applications from municipalities in states that did not apply and territories. For purposes of this report, when we refer to "states" we are referring generally to all SSBCI participants.

⁴12 U.S.C. § 4107(c) and 12 U.S.C. § 5710 (b).

⁵GAO, *Small Business Lending Fund: Additional Actions Needed to Improve Transparency and Accountability*, GAO-12-183 (Washington, D.C.: Dec. 14, 2011) and *State Small Business Credit Initiative: Opportunities Exist to Improve Program Oversight*, GAO-12-173, (Washington, D.C.: Dec. 7, 2011).

SSBCI compliance procedures and officials from the states of Colorado, Florida, Georgia, Illinois, Massachusetts, Michigan, New Jersey, Oregon, and Texas. Factors we used for selecting these states included the amount of funding provided by Treasury, geographic diversity, number and types of small business programs, and status of use of funds. Our selection process is more fully described in appendix I. We reviewed the Allocation Agreements between Treasury and each of the nine participating states that we interviewed to analyze the conditions and the requirements placed on the states.

To determine the status of SBLF participants' small business lending, we reviewed Treasury's Use of Funds Reports to determine the most current level of qualified small business lending and the distribution of dividend or interest rates paid by program participants.⁶ Because Treasury requires only SBLF participants to submit data on qualified small business lending—generally, lending below \$10 million—we also analyzed total business lending as well as small business lending under \$1 million, which is available through the Call Reports.⁷ We accessed Call Report data using SNL Financial—a private financial database that contains publicly filed regulatory and financial reports—and analyzed lending by SBLF participants for the quarter ending June 30, 2012. For the SSBCI program, we collected and reviewed data from the quarterly reports as of June 30, 2012, of all SSBCI participants.⁸ These data were the most recent available for our analysis. We determined that the data collected by Treasury on SBLF and SSBCI were sufficiently reliable for our purposes.

To examine the extent to which Treasury evaluates and communicates SBLF and SSBCI program outcomes, we reviewed Treasury documentation for both programs. To determine the extent to which Treasury evaluates the performance of SBLF, we reviewed Treasury's Use of Funds Report to identify how Treasury analyzed the performance

⁶The *Use of Funds Report* is a quarterly report to Congress describing how participating institutions have used the funds they have received under the program.

⁷A Call Report is the common reference name for the quarterly reports of condition and income filed with regulators by every national bank, state-chartered Federal Reserve member bank, and insured state nonmember bank.

⁸The act requires that SSBCI participants provide to Treasury a quarterly report on the use of SSBCI funds during the previous quarter.

of SBLF. We assessed the methodology and the comparison group Treasury used in evaluating the performance of SBLF participants as well as institutions that did not participate in SBLF. We interviewed Treasury officials on their comparison group analysis to understand the process by which the analysis was developed. To help understand the usefulness of the comparison group, we chose a peer group of non-SBLF institutions that we adjusted for geographical and size distribution as well as financial health. By analyzing a peer group, we could account for differences between SBLF participants and other financial institutions. For determining the extent to which Treasury evaluates SSBCI performance outcomes, we collected and reviewed the performance measures that Treasury developed for evaluating SSBCI. In addition, we interviewed officials from the nine selected states to collect information on their evaluation relating to their state's SSBCI performance and identify what type of performance information they think would be helpful in administering their state small business programs.

We conducted this performance audit from March 2012 to December 2012 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Small Business Lending Fund

For the purpose of the SBLF program, the Small Business Jobs Act of 2010 defines qualified small business lending—as defined in an institution's quarterly regulatory filings (Call Reports)—as one of the following:

- commercial and industrial loans;
- owner-occupied nonfarm, nonresidential real -estate loans;
- loans to finance agricultural production and other loans to farmers; and
- loans secured by farmland.

In addition, qualifying small business loans cannot be for more than \$10 million, and the business may not have more than \$50 million in revenue. The act specifically prohibits Treasury from accepting applications from

institutions that are on the Federal Deposit Insurance Corporation's (FDIC) problem bank list or have been removed from that list during the previous 90 days.⁹ The initial baseline small business lending amount for the SBLF program was the average amount of qualified small business lending that was outstanding for the four full quarters ending on June 30, 2010, and the dividend or interest rates paid by an institution are adjusted by comparing future lending against this baseline. Also, the institution is required to list any loans resulting from mergers and acquisitions so that its qualified small business lending baseline is adjusted accordingly.

Fewer institutions applied to SBLF than initially anticipated, in part because many banks did not anticipate that demand for small business loans would increase. The institutions that applied to and were funded by SBLF were primarily institutions with total assets of less than \$500 million. In addition, in our 2011 report, we reported that the lack of clarity by Treasury in explaining the program's requirements created confusion among applications and Treasury faced multiple delays in implementing the SBLF program and disbursing SBLF funds by the statutory deadline of September 27, 2011.¹⁰

The amount of funding a bank received under the SBLF program depended on its asset size as of the end of the fourth quarter of calendar year 2009. Specifically, if the qualifying bank had total assets of \$1 billion or less, it was eligible for SBLF funding that equaled up to 5 percent of its risk-weighted assets.¹¹ If the qualifying bank had assets of more than \$1 billion but less than \$10 billion, it was eligible for funding that equaled up

⁹The problem bank list is a confidential list created and maintained by the FDIC of banks that are in jeopardy of failing. In general, "problem" institutions are those institutions with financial, operational, or managerial weaknesses that threaten their continued financial condition. Depending upon the degree of risk and supervisory concern, they received a composite CAMELS rating of either "4" or "5." The CAMELS rating system is a U.S. supervisory tool that describes a bank's overall condition and that is used to classify the nation's banks. The composite rating is based on financial statements and regulators' on-site examinations and has six components—capital adequacy, asset quality, management, earnings, liquidity, and sensitivity to market risk—that make up the acronym. It rates banks on a scale of 1 to 5, with 1 being the strongest.

¹⁰GAO-12-183.

¹¹Risk-weighted assets are weighted according to credit risk and are used in the calculation of required capital levels. Specifically, all assets are assigned a risk weight according to the credit risk of the obligor or the nature of the exposure and the nature of any qualifying collateral or guarantee, where relevant.

to 3 percent of its risk-weighted assets. The SBLF program provided an option for eligible institutions to refinance preferred stock or subordinated debt issued to the Treasury through the Troubled Asset Relief Program's (TARP) Capital Purchase Program (CPP).¹² Participating SBLF banks must pay dividends or interest of 5 percent per year initially to Treasury, with reduced rates available if they increase their small business lending. Specifically, the dividend rate payable will decrease as banks increase small business lending over their baselines. While the dividend rate will be no more than 5 percent for the first 2 years, a bank can reduce the rate to 1 percent by generating a 10 percent increase in its lending to small businesses compared with its baseline. After 2 years, the dividend rate on the capital will increase to 7 percent if participating banks have not increased their small business lending. After 4.5 years, the dividend rate on the capital will increase to 9 percent for all banks regardless of a bank's small business lending. For S-corporations and mutual institutions, the initial interest rate was at most 7.7 percent. The rate would fall as low as 1.5 percent if these institutions increase their small business lending by 10 percent or more from the previous quarter.¹³ For CDLFs, the initial dividend rate will be 2 percent for the first 8 years. After 8 years, the rate will increase to 9 percent if the CDLF has not repaid the SBLF funding. This structure is designed to encourage CDLFs to repay the capital investment by the end of the 8-year period. Treasury will allow an SBLF participant to exit the program at any time, with the approval of its regulator, by repaying the funding provided along with dividends owed for that period.

Under the act, Treasury has a number of reporting requirements to Congress related to SBLF: (1) monthly reports describing all of the transactions made under the program during the reporting period; (2) a semiannual report (for the periods ending each March and September)

¹²As the largest TARP program, the Capital Purchase Program was designed to provide capital investments to financially viable financial institutions. Treasury received preferred shares and subordinated debentures, along with warrants.

¹³Some banking institutions are formed as either S-corporations or mutual organizations, which will affect the form of Treasury's investment. An S-corporation makes a valid election to be taxed under subchapter S of chapter 1 of the Internal Revenue Code and thus does not pay any income taxes. Instead, the corporation's income or losses are divided among and passed through to its shareholders. A mutual organization is a company that does not issue capital stock and, therefore, has no shareholders. It is also "owned" by its members (e.g., deposit customers) rather than by stockholders. Many thrifts and insurance companies are mutuals.

providing all projected costs and liabilities and all operating expenses; and (3) a quarterly report known as the Use of Funds Report.

**State Small Business
Credit Initiative**

SSBCI was established to support existing and new state programs that support private financing to small businesses and small manufacturers that, according to Treasury, are not obtaining the loans or investments they need to expand and to create jobs. The act allowed Treasury to provide SSBCI funding for two state program categories: capital access programs (CAP) and other credit support programs (OCSF). For both CAP and OCSFs, lenders are required to have at least 20 percent of their own capital at risk in each loan. Also, origination and annual utilization fees are determined by each state to defray the program's cost. Loan terms, such as interest and collateral, are typically negotiated between the lender and the borrower, although in some cases loan terms are subject to state approval and, in many cases, the state and lender will discuss and negotiate loan terms and guarantee options prior to reaching agreement to approve the loan and issue a guarantee. A CAP is a loan portfolio insurance program wherein the borrower and lender, such as a small business owner and a bank, contribute to a reserve fund held by the lender. Under a CAP, when a participating lender originates a loan, the lender and borrower combine to contribute an amount equal to a percentage of the loan to a loan reserve fund, which is held by the lender. Under SSBCI, the contribution must be from 2 percent to 7 percent of the amount borrowed. Typically, the contribution ranges from 3 percent to 4 percent. The state then matches the combined contribution and sends that amount to the lender, which deposits the funds into the lender-held reserve fund. Under SSBCI, approved CAPs are eligible to receive federal contributions to the reserve funds held by each participating financial institution in an amount equal to the total amount of the contributions paid by the borrower and the lender on a loan-by-loan basis.

In addition, the following OCSFs are examples of programs eligible to receive funding under the act:

- *Collateral support programs:* A Collateral Support Program is designed to enable financing that might otherwise be unavailable due to a collateral shortfall. It provides pledged cash collateral to lenders to enhance the collateral coverage of individual loans. The state and lender negotiate the amount of cash collateral to be pledged by the state.
- *Loan participation programs:* States may structure a loan participation program in two ways: (1) through purchase transactions, also known

as purchase participation, in which the state purchases a portion of a loan originated by a lender, or (2) by participating in a loan as a co-lender, where a lender originates a senior loan and the state originates a second loan to the same borrower that is usually subordinate to the lender's senior loan should a default occur. State loan participation programs encourage lending to small businesses because the lender is able to reduce its potential loss by sharing its exposure to loan losses with the state.

- *Loan guarantee programs:* These programs enable small businesses to obtain a term loan or line of credit by providing the lender with the necessary security in the form of a partial guarantee. In most cases, a state sets aside funds in a dedicated reserve or account to collateralize the guarantee of a specified percentage of each approved loan. The guarantee percentage is determined by the states and lenders but, under SSBCI, may not exceed 80 percent of loan losses.
- *Venture capital programs:* These programs provide investment capital to create and grow start-ups and early-stage businesses, often in one of two forms: (1) a state-run venture capital fund (which may include other private investors) that invests directly in businesses, or (2) a fund of funds, which is a fund that invests in other venture capital funds that in turn invest in individual businesses.
- *Direct loan programs:* Although Treasury does not consider these programs to be a separate SSBCI program type, it acknowledges that some states may identify programs that they plan to support with SSBCI funds as direct loan programs. The programs that some states label as direct loan programs are viewed by Treasury as co-lending programs categorized as loan participation programs, which have lending structures that are allowable under the statute.

OCSPs approved to receive SSBCI funds are required to target small businesses with an average size of 500 or fewer employees and to target support towards loans with an average principal amount of \$5 million or less. In addition, these programs cannot lend to borrowers with more than 750 employees or make any loans in excess of \$20 million.

After their applications were approved, the states entered into Allocation Agreements with Treasury before they received their funds. SSBCI Allocation Agreements are the primary tool signed by Treasury and each participating state and outline how recipients are to comply with program requirements. The act requires that each state receive its SSBCI funds in three disbursements or tranches of approximately one-third of its approved allocation. Prior to receipt of the second and third

disbursements, a state must certify that it has expended, transferred, or obligated 80 percent or more of the previous disbursement. Treasury may terminate any portion of a state's allocation that Treasury has not yet transferred to the state within 2 years of the date on which its SSBCI Allocation Agreement was signed. Treasury may also reduce, suspend or terminate a state's allocation at any time during the term of the Allocation Agreement upon an event of default under the agreement. Under the act, states are required to submit quarterly and annual reports on their use of SSBCI funds. All SSBCI Allocation Agreements will expire on March 31, 2017.

Treasury Has Made Progress in Developing Compliance Guidance and Processes for SBLF and SSBCI

In response to our previous recommendation on SBLF compliance procedures, Treasury has developed procedures for monitoring SBLF participant compliance with legal and reporting requirements. Treasury has also issued compliance standards for SSBCI and procedures to review states' annual reports. The standards provide the participating states with best practices for reviewing borrower and lender compliance with SSBCI's legal and policy requirements.

Treasury Has Developed Procedures to Monitor SBLF Participant Compliance and Report of Lending Data

We recommended in December 2011 that Treasury should finalize procedures for monitoring SBLF participants, including procedures to better ensure that Treasury is receiving accurate information on participants' small business lending.¹⁴ In response to the recommendation, Treasury officials told us they had written compliance procedures in March 2012 and finalized compliance procedures on September 28, 2012, for monitoring participant conformance with program terms, including documentation requirements, certification requirements, and other requirements under the Securities Purchase Agreement.¹⁵ In addition, according to Treasury officials, SBLF compliance procedures include a review of the Quarterly Supplemental

¹⁴GAO-12-183.

¹⁵The Securities Purchase Agreement is the terms between Treasury and SBLF participants on which the SBLF participants issued preferred stock to the Treasury, which Treasury purchased using SBLF funds.

Reports (quarterly reports) for accuracy to monitor that the dividend or interest rates paid by the institutions are correct.¹⁶

As mandated by the act, Treasury requires each SBLF participant to submit two annual certifications:

(1) Any businesses receiving a loan from an SBLF participant using SBLF funds must certify to the institution that the principals of the business have not been convicted of a sex offense against a minor. Under the Securities Purchase Agreement, annually until redemption, the SBLF participant is required to provide the certifications to Treasury that businesses receiving loans from the bank have certified that their principals have not been convicted of a sex offense against a minor.

(2) Each SBLF participant must certify that it is in compliance with the requirements of the Customer Identification Program, which is intended to enable the bank to form a reasonable belief that it knows the true identity of each customer.

In addition to these certifications, Treasury requires, through the Securities Purchase Agreement, that SBLF participants meet certain additional conditions and certifications, such as the bank's Chief Executive Officer and Chief Financial Officer attesting to the accuracy of the bank's Call Report and certifying to Treasury that information provided on each supplemental quarterly report, is complete and accurate. Treasury developed a compliance monitoring tool for verifying the proper certification submission by SBLF participants. The tool is a set of spreadsheets Treasury uses to track the receipt of documents from SBLF participants, as required by the Securities Purchase Agreement, including annual financial statements, independent auditor certifications, and executive officer certifications.

An important SBLF compliance focus is the review and monitoring of the quarterly reports. Each SBLF participant is required to correctly calculate its quarter-end adjusted small business lending baseline and the qualified

¹⁶ Quarterly Supplemental Reports supplement the Call Reports filed by the SBLF participants and include the calculations for the qualified small business lending for the quarter and the dividend or interest rate to be paid by the SBLF participants.

small business lending for that quarter.¹⁷ The quarterly reports are the primary source on which Treasury bases its Use of Funds Report of qualified small business lending and the dividend or interest rate paid by the SBLF participants. The quarterly reports are forms in which the SBLF participants calculate their qualified small business lending for the quarter and the resulting dividend or interest rate. The dividend or interest payment depends on the growth or the decline of qualified small business lending. Thus, if the baseline or the qualified small business lending is incorrectly calculated, Treasury will not receive an accurate dividend or interest payment amounts.

According to Treasury documentation, Treasury will review the following elements in the quarterly reports:

- certification of accuracy by the institution's executives (including Chief Executive Officer, Chief Financial Officer, and all directors or trustees who attested to the Call Report);
- independent auditor certification;
- real-time validation of the calculations for the quarterly reports;
- analysis of the quarterly reports; and
- explanation letters and auditor attestations if the quarterly report is a resubmission.

According to Treasury officials, the review performed by SBLF compliance staff is primarily to identify discrepancies between data on the quarterly reports and the Call Reports. According to Treasury staff, they use a system that allows staff to monitor discrepancies or errors and follow up with participants. Treasury staff review participants' quarterly reports to identify any potential errors or missing information. Staff compare the quarterly report submissions to the Call Reports to check for discrepancies for the same period. According to Treasury officials, staff also compare quarterly reports to prior Call Reports to check for errors in reported changes in loan balances and net charge-offs and apply statistical tests, such as a comparison of government guaranteed lending amounts in the quarterly reports, to lending figures publicly reported by

¹⁷The SBLF qualified baseline is adjusted each quarter to take into account any gains resulting from mergers, acquisitions, and loan purchases during the period that SBLF participants may have acquired during the period. The baseline is adjusted so that the small business lending being measured is new small business lending, not lending from mergers, acquisitions, or purchases of small business loans.

the Small Business Administration.¹⁸ Treasury staff said they use a verification check for arithmetic errors for calculating the adjusted baseline exclusions and qualified small business lending. Treasury follows up with institutions to address identified issues and errors and requests resubmission of corrected quarterly reports, as appropriate.

Treasury has also responded to the findings and recommendations of the Treasury's Office of Inspector General (OIG). In August 2012, Treasury's OIG reported on a small judgmental sample of 10 initial supplemental reports submitted by SBLF participants.¹⁹ To establish initial dividend rates, SBLF participants completed the initial supplemental reports using small business lending data from their quarterly Call Reports and loans records and submitted them to Treasury. The OIG reviewed the calculations for the small business lending baseline and the initial dividend rate payment and found errors in 8 of the 10 reviewed reports. OIG's recommendations included the following:

- follow up with the 8 banks where errors were identified and determine whether corrected initial supplemental reports and quarterly reports should be submitted and make the necessary adjustments to dividend rates for the banks, as appropriate;
- notify all SBLF participants about the types of errors identified by this audit to help prevent similar errors from occurring in the future; and
- ensure that the October 2012 Use of Funds Report contains corrections for errors identified by this audit.

Treasury agreed with the OIG's recommendations and commented that it would review the identified errors with each institution and direct these institutions to resolve any errors in the third quarter of 2012, including resubmitting corrected initial and quarterly supplemental reports, as appropriate. Further, Treasury conducted training webinars in July and August 2012 to address common errors identified in their reviews of quarterly report submissions. According to Treasury officials, they completed the review of the eight banks where quarterly report errors

¹⁸Net charge-offs are total loans and leases charged off (removed from balance sheet because of uncollectibility), less amounts recovered on loans and leases previously charged off.

¹⁹Department of the Treasury, Office of Inspector General, *Small Business Lending Fund: Initial Dividend Rate Calculations Used Incorrect Lending Information*, (Washington, D.C.: Aug. 21, 2012).

were identified and banks resubmitted quarterly reports as appropriate. Two banks submitted revised reports identifying a combined total of \$258.00 in overpayments to Treasury.

Treasury Has Developed Guidance to Assist SSBCI-Participating States in Their Oversight of Lenders and Borrowers

Treasury has developed SSBCI Policy Guidelines and compliance standards for participating states to follow in implementing their state small business programs using SSBCI funds. According to Treasury officials, primary oversight of the use of SSBCI funds is the responsibility of each participating state. The participating states we interviewed viewed their responsibility as monitoring SSBCI lender and borrower compliance with program requirements. Under the act, specific lender and borrower assurances and certifications must be delivered before a transaction is enrolled in the participating state's approved program. For example, borrowers must provide assurance that proceeds will be used for an eligible business purpose and that the borrower is not an executive officer, director, or principal shareholder (or a member or the immediate family or a related interest of such individual) of the lender. Similarly, lenders must submit certifications to the participating state providing assurance that, for example, the loan is not a refinancing of a loan previously made to that borrower by the lender or an affiliate of the lender. In addition to these certifications, the act requires that borrowers and the lenders certify that their principals have not been convicted of a sex offense against a minor as such terms are defined in section 111 of the Sex Offender Registration and Notification Act.²⁰ Eight states we interviewed told us that they reviewed borrower and lender certifications for meeting the legal requirements and assurances before enrolling the loans.

In May 2012 Treasury issued the SSBCI National Standards for Compliance and Oversight, which was intended to provide the states with guidance for reviewing, monitoring, and managing compliance.²¹ Treasury considers the standards as best practices that the states should adopt or incorporate, as appropriate, into existing procedures. For example, according to the standards, if a participating state delegates to an administrative entity the responsibility to obtain the certifications to

²⁰42 U.S.C. § 16911.

²¹U.S. Department of the Treasury, *SSBCI National Standards for Compliance and Oversight*, (Washington, D.C.: May 15, 2012).

individual lenders, the participating state must exercise oversight to ensure compliance. One means of ensuring oversight would be for the participating state to conduct an annual audit of each lender's transaction files to verify that the use of proceeds certifications are on file and signed by an authorized representative of the lender. As another example of a best practice, the standards recommend that, when overseeing entities that administer the state small business programs, states should perform site visits, require periodic status update reports, or conduct regular conference calls with the administering entity.

The participating states we interviewed found the SSBCI National Standards for Compliance and Oversight to be helpful as they were developing their compliance procedures. Three of the nine states already had similar compliance procedures in place for their small business lending and amended their procedures to include SSBCI compliance standards. Six states told us that they established or are establishing compliance standards using the SSBCI National Standards for Compliance and Oversight as guidance. According to state officials of the nine states we interviewed, as part of their procedures, staff reviewed the borrower and lender documentation for compliance.

Under the act, SSBCI participants are subject to two reporting requirements: annual reports and quarterly reports. As part of its responsibilities for overseeing the use of SSBCI funds, Treasury is planning to conduct a review of the Annual Report data submitted to them by the states. Under the act, SSBCI participants are to submit to Treasury an Annual Report no later than March 31 of each year. The data included

- transaction-level data for each loan or investment made using SSBCI funds for that year;
- the number of borrowers that received new loans originated under the approved state program;
- the total amount of such new loans;
- breakdowns by industry type, loan size, annual sales, and number of employees of the borrowers that received such new loans;
- the zip code of each borrower that received such a new loan; and
- other data that the Secretary may require to carry out the purposes of the program.

As part of its review of the 2012 Annual Report data, Treasury plans to review a sample of loans and investments for the appropriate documentation of borrower and lender assurances and certifications for data accuracy. To conduct this review, SSBCI staff designed an

evaluation form to review the certifications and the Annual Report data. SSBCI participants are required to submit their 2012 annual data to Treasury by March 31, 2013. The loans or investment will be reviewed for the following assurances and certifications:

- Each lender or investor that has received credit support for a particular transaction has at least 20 percent of their own capital at risk unless Treasury has waived this requirement.
- Signed borrower and lender use-of-proceeds certifications have been provided, and the borrower/lender signature block matches the borrower on the loan documents.
- Signed borrower and lender sex offender certifications have been provided.

In the data accuracy review, Treasury plans to verify a sample of SSBCI Annual Report data submitted by the states with the actual loan or investment documentation. The types of data that Treasury intends to verify include the following:

- date of disbursement for the loan or investment;
- borrower's annual revenue and the year of business incorporation;
- enrolled loan amount and any public subsidy associated with the enrolled loan or venture capital investment;
- SSBCI federal contribution to CAP loan; and
- amount the state had contributed to a loan participation, loan guarantee, or loan collateral program.

Treasury also intends to verify that the amount of subsequent private financing matches the documentation provided and that the documentation supports the relationship between the SSBCI loan program and the private financing.

The states are required to submit to Treasury a quarterly report on the use of SSBCI funds during the previous quarter. Under the act, states are required to report the total amount of federal funding used and to certify that the information provided is accurate and that the state is implementing its approved programs in accordance with the act and the regulations or other guidance issued by Treasury. As part of the Allocation Agreements, Treasury also requires states to submit reports on the total amount of allocated funds used for administrative costs, the amount of program income generated, and the amount of charge-offs against the federal contributions to the reserve funds. Treasury conducts a more limited review of the SSBCI quarterly reports compared to the

Annual Report. Specifically, Treasury staff conduct checks on the administrative costs to ensure that the costs do not exceed the statutory caps. In addition, staff verify that the amount of funds used does not exceed the amount allocated to the state and that the state official signing the SSBCI quarterly reports is authorized to do so.

According to Treasury officials, they would not approve a new disbursement of funds if they had substantial evidence that a state's compliance with SSBCI program requirements was inadequate. When a participating state requests a disbursement of funds, according to Treasury staff, they will conduct a pre-disbursement review. In addition to confirming that the participating state has expended, obligated, or transferred 80 percent of its previous disbursement, Treasury staff review the results of Treasury's SSBCI compliance monitoring. According to Treasury documentation, this review will include a review of a sample of transactions in which SSBCI funds were used; a review of financial audits, if submitted; the review of the quarterly reports and if available, the annual reports for accuracy and completeness; and the review of any of the states' compliance activities or records that would indicate whether a participating state had failed to comply with any program requirements.

**SBLF-Funded
Institutions and
SSBCI-Funded States
Have Begun to
Support Small
Business Lending, but
Treasury's Policy for
Timely Use of SSBCI
Funds Is Unclear**

As of June 30, 2012, SBLF participants had increased their business lending over the baseline from 2010.²² For SSBCI, Treasury had transferred to the states nearly one-third of the program's \$1.5 billion in total funding as of June 30, 2012. States had used about \$154 million (about 10 percent) of these funds through a variety of programs. States had received and used funds at differing levels, but some states were concerned that Treasury may take actions to suspend disbursements after participants have been in the program for more than 2 years. Treasury has the authority to terminate disbursements to SSBCI participants who have not met the requirements to receive their full allocation within 2 years of having been accepted into the program. Treasury has not yet developed a policy that reflects how it will use this authority even though this 2-year period will end for most states sometime in 2013. Treasury officials stated that they do not plan to use this authority

²²These financial data are reported on a quarterly basis, and June 30, 2012, represents the most recent data available.

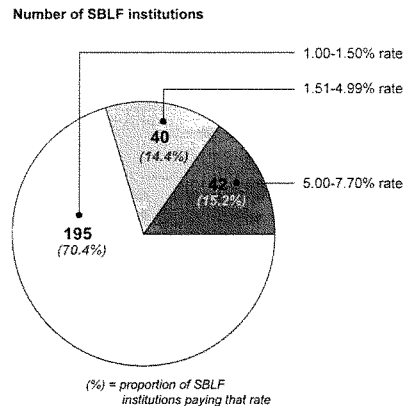
at this time and that Treasury will provide all participants with sufficient lead time so that they can modify or adjust their programs, as necessary.

SBLF Participants Have Generally Increased Their Levels of Both Small Business and Total Business Lending

According to Treasury, SBLF participants have increased their qualified small business lending by \$6.7 billion over their \$36.0 billion baseline, as of June 30, 2012. This number includes a \$1.5 billion increase over the prior quarter. Further, Treasury reported that 89 percent of participants had increased their qualified small business lending over baseline levels and about 76 percent of participants had increased their qualified small business lending by 10 percent or more. As previously discussed, SBLF uses a dividend or interest rate incentive structure to encourage participating institutions to increase qualified small business lending. SBLF participants paid an average dividend or interest rate of 2.1 percent on their SBLF funds as of June 30, 2012. Over half of SBLF participants paid a dividend or interest rate of 1 percent on their SBLF funds—because their qualified small business lending growth was 10 percent or higher—and 15 percent of institutions paid 5 percent or more (see fig. 1).²³

²³As mentioned earlier, dividends or interest rates for S-corporations range from 1.5 percent to 7.7 percent depending on their increases in qualified small business lending. Treasury used these differing rates to ensure that S-corporations' after-tax rate was equal to that of other participating institutions (1.0 percent to 5.0 percent). Figure 1 displays the pre-tax dividend or interest rates, but groups the rates in a way that more closely mirrors the corresponding loan growth changes.

Figure 1: Distribution of Dividend or Interest Rates Paid by Institutions on SBLF Funds, as of June 30, 2012



Source: GAO analysis of Treasury data.

SBLF participants also showed increases in small business loans under \$1 million, as well as total business lending. While the Small Business Jobs Act set the threshold for qualified small business lending at \$10 million, depository institutions are required to submit Call Reports with detailed financial information including small business lending, which the reports define as loans under \$1 million.²⁴ Such data are useful for comparing certain small business lending of SBLF participants with that of institutions that did not participate in SBLF.²⁵ Total business lending—which includes all business loans, including loans over \$10 million and

²⁴Call Reports require reporting only on loans up to \$500,000 for two of the loan categories—loans to finance agricultural production and loans secured by farmland. The \$1 million threshold applies to the other two categories—commercial and industrial loans and nonfarm, nonresidential real estate loans.

²⁵Because qualified small business lending—lending below the \$10 million threshold—is defined by the Small Business Jobs Act, only SBLF participants are required to submit these data, leaving the data unavailable for institutions that did not participate in SBLF.

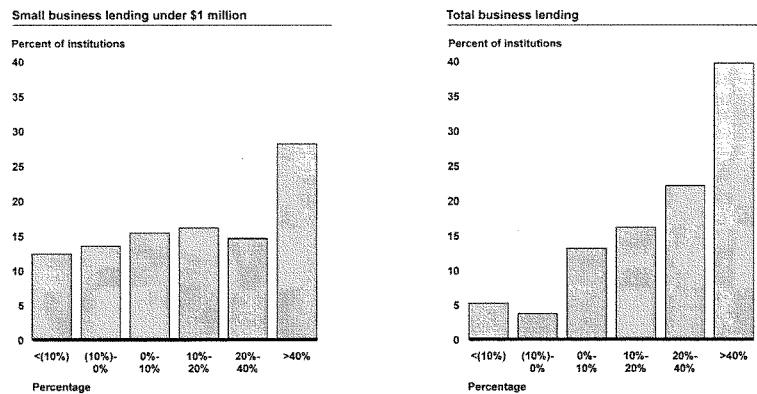
those to businesses with over \$50 million in revenue—can also help illustrate differences in lending activity between these two groups.²⁶ Treasury uses total business lending in its reporting to compare SBLF participants to non-SBLF institutions and noted that qualified small business lending makes up a large part of total business lending for SBLF participants. For example, qualified small business lending totaled 95 percent of total business lending for the median SBLF participant as of December 31, 2011.

SBLF participants increased both small business loans under \$1 million as well as total business lending. In particular, the median SBLF participant had a 31 percent increase in total business lending for the quarter ending June 30, 2012, over the baseline level.²⁷ The median SBLF participant had a 14 percent increase for small business loans under \$1 million over the same period. When categorizing SBLF participants by the changes in their lending, the SBLF participants fell into the higher growth categories for total business lending, but were more evenly distributed for small business loans under \$1 million except for participants whose lending increased over 40 percent (see fig. 2).

²⁶Total business lending only includes lending to the same four loan categories as qualified small business lending.

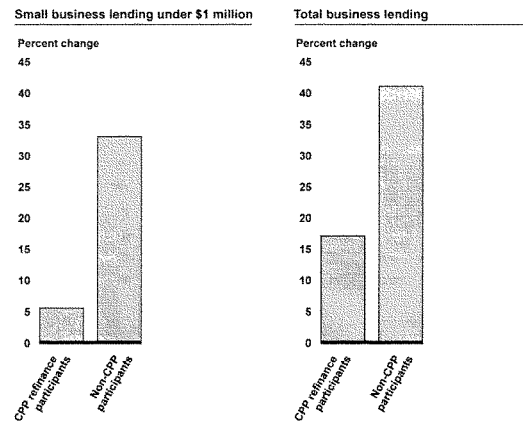
²⁷The act establishes the baseline for measuring the change in small business lending as the average of the amounts that were reported for each of the four calendar quarters ended June 30, 2010. Call Reports did not begin requiring quarterly reporting of small business lending under \$1 million until the second quarter of this four quarter baseline period. Accordingly, we calculated the baseline for small business lending under \$1 million using the average of each of the three calendar quarters ended June 30, 2010. The act also defines one of the categories of qualified small business lending as owner-occupied nonfarm, nonresidential real estate loans. For quarterly reports of small business lending, Call Reports use a broader category of all nonfarm, nonresidential real estate without a distinction for owner occupancy. As a result, the small business lending under \$1 million includes the broader category. The total business lending numbers use the full baseline and the narrower categorization of owner-occupied nonfarm, nonresidential real estate and should therefore not be compared to the numbers for small business lending under \$1 million.

Figure 2: Distribution of SBLF Participants' Changes in Business Lending, from Baseline Level to the Quarter Ended June 30, 2012



About half of SBLF participants used their program funds to repay and exit TARP's CPP. These CPP refinance participants had noticeably lower lending growth than SBLF participants that did not participate in CPP (see fig. 3). In particular, CPP refinance participants increased small business loans under \$1 million by 5 percent compared with 33 percent for non-CPP participants. For total business lending, CPP refinance participants saw increases of 17 percent compared with 45 percent for non-CPP participants. Treasury officials said that one possible reason for this difference is that CPP refinance participants were only eligible for a limited amount of incremental SBLF funds, beyond the amount of CPP funds refinanced. As a result, unlike other SBLF participants, these institutions did not receive as much "new" capital to increase small business lending. Nevertheless, all SBLF participants are subject to the same incentive structure based on the dividend or interest rate. Furthermore, Treasury officials also noted that in many instances the CPP refinance participants may have already experienced an increase in lending from the CPP capital they originally received.

Figure 3: Median Changes in SBLF Participants' Business Lending by CPP Status, from Baseline Level to the Quarter Ended June 30, 2012

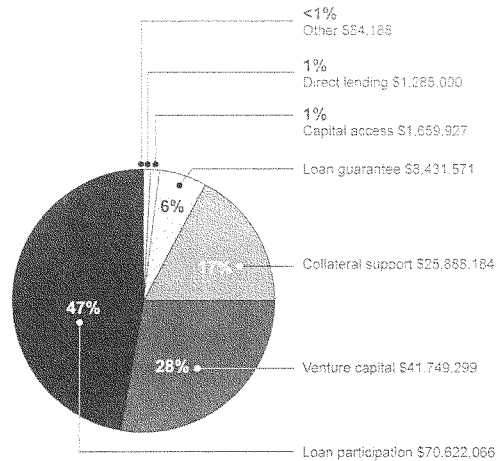


Source: GAO analysis of SNL Financial data.

States Disbursed SSBCI Funds through Different Types of Programs and at Varying Rates

As of June 30, 2012, Treasury had transferred \$468 million in SSBCI funding to the states, representing about one-third of the \$1.5 billion that was set aside for the program. States had used \$150 million of these funds—about 10 percent of the program total—disbursing them to lending institutions through a variety of programs. Loan participation programs accounted for 47 percent of the funds used, as of June 30, 2012, followed by venture capital programs (28 percent), collateral support programs (17 percent), and loan guarantee programs (6 percent), as shown in figure 4. The remaining program categories—capital access programs, direct lending, and other—combined for the remaining 2 percent of funds used.

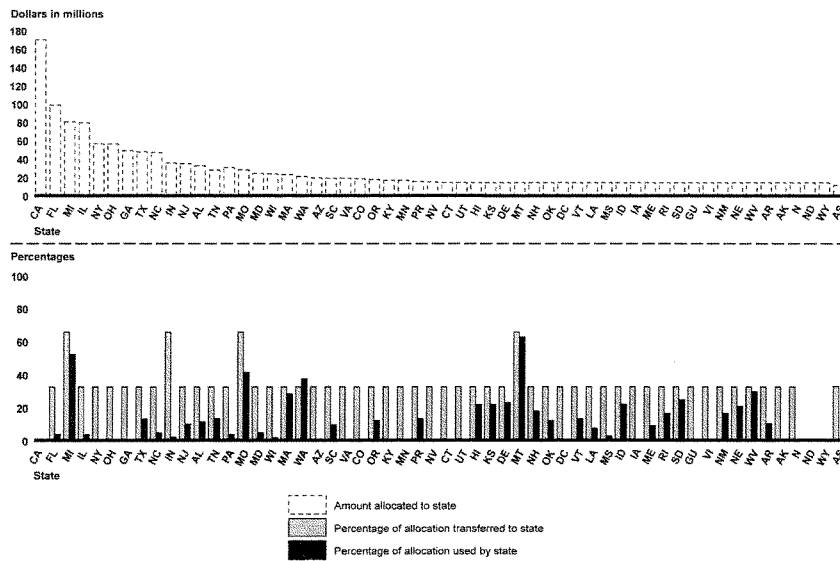
Figure 4: Cumulative SSBCI Funds Used by Program Type, as of June 30, 2012



Source: GAO analysis of Treasury data.

Participating states have received and used SSBCI funds at differing levels, partially because of when applications were approved and funds were allocated (see fig. 5). Of the 53 states, territories, or municipalities that received SSBCI funding, 47 had used a proportion of their funds as of June 30, 2012. Montana had the highest proportion used of the amount that Treasury had allocated, as of June 30, 2012. States we interviewed said that disbursing funds was much faster for state programs that were in existence before SSBCI because the infrastructure was already in place and lenders were already familiar with the programs. Moreover, some states implementing new programs told us that it could take time to use the funds because they had to conduct extensive outreach to lenders to make them aware of the programs and encourage them to commit to small business lending.

Figure 5: SSBCI Allocation by State, Territory, or Municipality and Cumulative SSBCI Funds Transferred and Used, as of June 30, 2012



Source: GAO analysis of Treasury data.

Note: States are in order of the largest to smallest allocation amount. California had been allocated \$168.6 million, but its transferred and used amounts were not available for the June 30, 2012, quarterly report due to an extension granted. Washington's amount used is greater than its transferred amount because it includes loan commitments that are contingent upon receipt of its next disbursement. Alaska did not participate in SSBCI, and "AK" reflects the city of Anchorage, which applied for funding at the municipal level. "N" refers to the Northern Mariana Islands. North Dakota did not apply for SSBCI funds, but two consortia of municipalities in North Dakota—the Mandan Consortium and the Carrington Consortium—applied, approved, and received funding on August 31, 2012, and September 28, 2012, respectively. Wyoming did not apply for SSBCI funds, but one consortium of municipalities—the Laramie Consortium—applied for funds and was approved.

**Treasury Has Not Yet
Developed a Policy on
How to Treat States That
Do Not Meet SSBCI's 2-
Year Time Frame**

Under the act, the Secretary may revoke any portion of a participating state's allocated amount that has not been transferred to the state by the end of the 2-year period beginning on the date the state received approval, but Treasury has not developed a written policy on how it will use this authority. For most of the participating states, this 2-year period will end sometime during 2013, but it is still unknown if they all will be able to use their funds in time to obtain the third and final disbursement within this time frame. This time frame is quickly approaching for five states (California, Hawaii, Missouri, North Carolina, and Vermont) that signed their Allocation Agreements with Treasury before May 2011. For 39 states the 2-year time frame will end by September 30, 2013, in terms of their allocation agreement. As of November 16, 2012, according to Treasury, ten states (Idaho, Indiana, Kansas, Michigan, Missouri, Montana, North Carolina, South Carolina, South Dakota, and Washington) had requested and received their second disbursement; eight states (Arkansas, Delaware, Florida, Louisiana, Massachusetts, New Hampshire, New Jersey, and West Virginia) had requested their second disbursement but had not yet received it; and one state, Montana, had requested and received a partial third disbursement. The remaining 38 SSBCI participants were still working to use their first disbursement, as of November 16, 2012.

Some states told us that the 2-year time frame is short for disbursing SSBCI funds especially for states with new state small business programs. One state official told us that because their programs are relatively new and lending institutions are unfamiliar with them, the 2-year time frame is too tight for lenders to make informed decisions about participating in the program. Similarly, officials from two states told us that the 2-year time frame for disbursing the SSBCI funds is short because their state small business programs were newly created.

According to Treasury officials, Treasury is aware of the 2-year time frame and the potential concerns of the states. After reviewing the law, Treasury officials told us that the Secretary has discretion on whether or not to revoke the undisbursed allocation if it has not been transferred to a participating state as of the 2-year anniversary. According to Treasury officials, they have not drafted a policy or procedures on what actions they may implement if the states miss the 2-year time frame for their final disbursement of funds. However, they told us that the states were encouraged to describe in their applications how they would disburse the funds within the 2-year time frame and that they advised the states of the importance of meeting the 2-year time frame. Moreover, they said that they do not consider the 2-year time frame to be a requirement that funds

not yet transferred must be deemed unavailable at that time. At an October 2012 conference attended by many SSBCI participants, according to Treasury staff, the Deputy Assistant Secretary for Small Business, Community Development, and Affordable Housing Policy told the participants that Treasury did not currently plan to exercise this authority in the near future. However, these statements are not currently documented in a written or formal policy statement explaining its position. Treasury staff told us when Treasury develops a policy on its discretionary authority, it will provide all participants with sufficient lead time so that they can modify or adjust their programs, as necessary. Treasury officials told us that the purpose of the Deputy Assistant Secretary's conference announcement was to address the concern and clarify that Treasury would not be taking action at this time if an SSBCI participant had not met the 2-year requirement and to affirm that Treasury retains its discretionary authority going forward.

In prior work, we have recommended that when states are required to spend federal funds to meet a statutory deadline or specific program requirements, agencies should provide guidance to the states on what they should expect if they are unable to meet the deadline.²⁸ The act provides Treasury's discretionary authority to encourage the states to use the funds in a timely manner, but without a formal written policy, how Treasury would use this authority in a consistent manner is unclear. Having clear guidelines on how Treasury plans to use its discretionary authority to terminate funds could help ensure consistent application of the authority. In addition, such guidelines could help states understand the need to use the funds in a timely manner while meeting program requirements and could provide clarity to states about the associated consequences of not meeting the 2-year time frame.

²⁸GAO, *Recovery Act: Progress and Challenges in Spending Weatherization Funds*, GAO-12-195 (Washington, D.C.: Dec. 16, 2011) and *Recovery Act: States' and Localities' Uses of Funds and Actions Needed to Address Implementation Challenges and Bolster Accountability*, GAO-10-604 (Washington, D.C.: May 26, 2010).

Treasury Could Enhance Its Reporting of Program Performance Information

Treasury has established performance measures to manage its programs but could enhance its public reporting of program performance information. In its Use of Funds Report, Treasury compared business lending by SBLF participants to that of non-SBLF institutions, but the report does not disclose Treasury's rationale for choosing its comparison group over other possibly more representative alternatives. Treasury officials told us that they are continuing to consider different approaches for evaluating SBLF. In addition, Treasury has designed SSBCI timeliness and outcome performance measures but has not made this information publicly available. Treasury officials are considering different options for presenting this information and said they plan to eventually to make some of it public. However, Treasury has not made any decisions on the specific SSBCI performance information that it might publicly release. Treasury has also taken actions to enhance its communications with SBLF and SSBCI program participants, such as dedicating staff to assist with participants' inquiries.

Additional Information on Treasury's Methods for Analyzing SBLF Outcomes Would Enhance Transparency

Our review found that SBLF participants had noticeably higher changes in lending rates when compared to similar non-SBLF institutions, but that Treasury's methods for analyzing SBLF participants' lending may somewhat overstate differences between SBLF participants' lending and that of other eligible banks. In our December 2011 report on SBLF, we recommended that Treasury finalize plans for assessing the performance of the SBLF program, including measures that can isolate the impact of SBLF from other factors that affect small business lending.²⁹ Treasury officials explained to us that they explored different comparison methods that more closely mirror SBLF participants, but this information is not disclosed in its Use of Funds Report to Congress.

In its Use of Funds Report, Treasury compared total business lending by SBLF participants to that of a comparison group of non-SBLF institutions and found that SBLF participants had noticeably higher increases in total business lending. In its analysis, Treasury adjusted the comparison group for a number of factors, including an institution's asset size and geography, thereby excluding institutions that fell outside the asset size range of SBLF participants and that were headquartered in states that did

²⁹GAO-12-183.

not have an institution participating in SBLF.³⁰ Such a comparison is a helpful step in understanding the possible effects of SBLF funding. However, Treasury did not adjust its comparison group to better ensure that its distribution among various asset sizes and states mirrored that of SBLF participants. Moreover, Treasury did not adjust its comparison group to account for differences in financial health despite requiring SBLF applicants to demonstrate a certain degree of financial health before approving them for funding. For example, the act specifically restricted Treasury from accepting applications from institutions that were on or recently removed from the FDIC problem bank list. Because the comparison group did not exclude such institutions that were unable to qualify for SBLF funding, these institutions may have downwardly skewed the group's small business lending growth rate, thus causing Treasury's results to overstate the implied effect of the program. As a result, Treasury's analysis seemingly links SBLF funding to the increase in small business lending when that increase, to some extent, may have been associated with the factors mentioned above or other factors such as improved local economic growth.

To analyze the differences in lending between SBLF participants and non-SBLF institutions, we chose a peer group that we adjusted for geographical and size distribution as well as financial health.³¹ In nearly every case, the loan growth of our peer group was slightly closer than Treasury's comparison group to the loan growth of SBLF participants, implying that Treasury's choice not to adjust for these differences may have resulted in it slightly overstating the differences between these groups, and by implication, the program's effect on small business loan

³⁰Treasury's comparison group was comprised of the 6,463 non-SBLF insured depository institutions that were established prior to September 30, 2009, had total assets between \$7.0 million and \$6.4 billion (the range of total assets for SBLF participants) as of March 31, 2011 (the end of the first quarter prior to SBLF participants receiving funding), and are located in one of the jurisdictions (44 states and the District of Columbia) in which SBLF participants are headquartered.

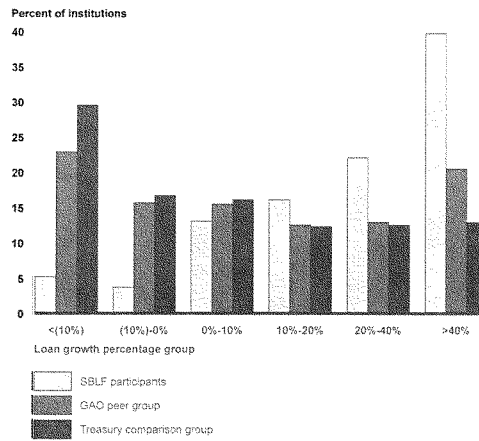
³¹We used the Texas Ratio as a proxy for financial health. It is defined as nonperforming assets plus loans 90 or more days past due divided by tangible equity and reserves. The Texas Ratio helps determine a bank's likelihood of failure by comparing its troubled loans to its capital. Because SBLF funding increases the equity portion of the ratio, we used Texas Ratios as of March 31, 2011, which was the last quarter preceding the initial disbursements of SBLF funding.

growth.³² That is, growth rates of SBLF participants remained noticeably higher than those of our peer group. This growth could indicate a beneficial effect of SBLF funding on lending, or it could be due to other factors, including differences between SBLF participants and our peer group for which we were not able to adjust. When categorizing institutions by the level of change in their business lending, SBLF participants were more heavily concentrated in the higher growth categories compared with the peer and comparison groups (see fig. 6).³³ Moreover, the median SBLF participant had a 31 percent increase in total business lending, compared with a 2 percent increase for the comparison group and a 6 percent increase for the peer group.

³²We replicated Treasury's comparison group using the methodology it outlined in its *Use of Funds Report*. This replication may not be identical to Treasury's actual comparison group, but we determined that it was sufficiently similar for the purposes of our analysis. In all comparisons of total business lending growth between SBLF, peer, and comparison groups, we calculated the baseline using the average of the four quarters ending June 30, 2010. The data limitation mentioned earlier that required us to use only three quarters in the calculation of the baseline only applied to the availability of data on small business loans under \$1 million, and the three-quarter baseline was used only in those earlier sections.

³³As mentioned earlier, Treasury used total business lending to compare lending between SBLF participants and the comparison group because qualified small business lending data were not available for non-SBLF institutions and because qualified small business lending totaled 95 percent of total business lending for the median SBLF participant as of December 31, 2011.

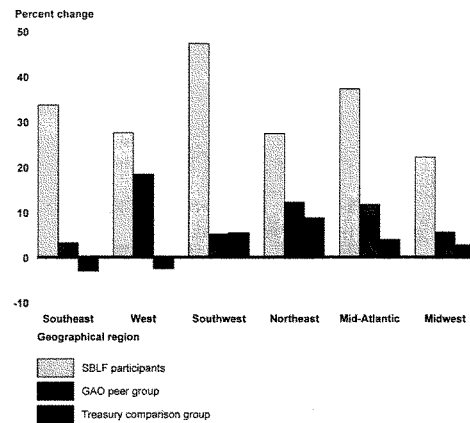
Figure 6: Distribution of Changes in Total Business Lending, from Baseline Level to the Quarter Ending June 30, 2012



Source: GAO analysis of SNL Financial data.

Further, SBLF participants had a higher median growth rate of total business lending than both our peer group and Treasury's comparison group in all six geographical regions (see fig. 7). Moreover, the peer group had higher rates of growth than the comparison group in five of the six regions.

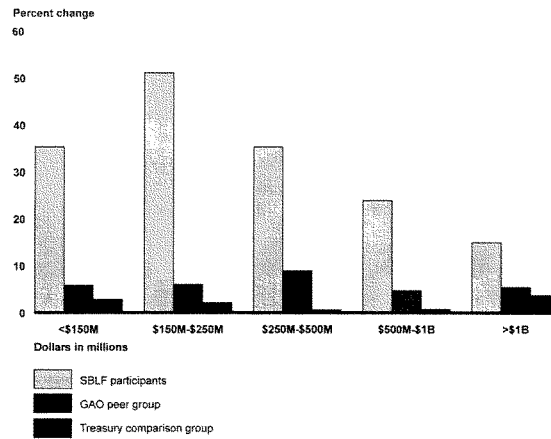
Figure 7: Median Changes in Total Business Lending by Geographical Region, from Baseline Level to the Quarter Ending June 30, 2012



Source: GAO analysis of SNI Financial data.

SBLF participants also had a higher median growth rate of total business lending across all five asset size categories (see fig. 8). Again, the peer group's growth rate was slightly closer to that of SBLF participants than the comparison group was for all five asset groups, yet it remained well below it. Moreover, SBLF participants in the larger asset categories had lower growth rates in total business lending. However, the peer and comparison groups had no noticeable trend across different asset size groups. In addition, the peer and comparison groups were closest to SBLF participants among institutions with assets over \$1 billion.

Figure 8: Median Changes in Total Business Lending by Institution Size in Total Assets, from Baseline Level to the Quarter Ended June 30, 2012



Source: GAO analysis of SNL Financial data.

Treasury officials said that in determining the comparison group to use in their analysis, they analyzed distributional differences in asset size and geography between the groups, as well as some indicators of financial health. They judged that the differences in the variables they analyzed were modest and believed that adjusting for these differences—that is, making the comparison group more representative of SBLF participants—would only provide a limited benefit while making the analysis less transparent and more difficult for others to replicate. They were also concerned that using what they considered to be a more judgmental approach, such as selecting a peer group, would require certain arbitrary decisions which might raise concerns about the validity of their selection criteria. As a result, Treasury determined that the differences found in their analyses did not warrant an approach that would adjust for these factors.

In addition, although Treasury officials told us they considered but decided against using a comparison group that would have been adjusted

to more closely mirror SBLF participants; they did not explain this decision in the methodology section of the Use of Funds Report. In prior work on another Treasury program, we said that Treasury should enhance its communications relating to financial assistance so that they are transparent to the Congress and the public.³⁴ Without disclosing its rationale for choosing its comparison group over other possibly more representative alternatives, Treasury may not be providing policymakers with a full understanding of its approach and may not be transparent regarding the potential for its analysis to overstate the effects of SBLF.

Treasury's comparison group analysis in its Use of Funds Report also does not isolate the impact of SBLF relative to other factors affecting small business lending to the extent that other approaches would. While a comparison group is an important step and provides useful context, a more rigorous analysis of peer banks to help assess what might have happened without SBLF, as our 2011 report on SBLF recommends, may help Treasury better understand the effects of the program. Our prior work on program evaluation suggests that a carefully constructed control group should be as similar to program participants as possible to help identify the impact of a program, and a number of statistical methods can help account for differences.³⁵ Furthermore, Treasury's concerns about making arbitrary judgments in the selection of peers could be addressed by conducting a sensitivity analysis—a best practice also identified by the Office of Management and Budget—which involves varying assumptions to determine how sensitive results are to changes in those assumptions.³⁶

Treasury officials said they are looking for a way to improve their analysis of SBLF and they have designed a lending survey to collect information from SBLF participants on their small business lending and outreach activities. They said that the survey will help them assess SBLF. The survey covers the following issues: the participant's standards for

³⁴See GAO, *Troubled Asset Relief Program: As Treasury Continues to Exit Programs Opportunities to Enhance Communication on Cost Exist*, GAO-12-229 (Washington, D.C.: Jan. 9, 2012).

³⁵See GAO, *Program Evaluation: A Variety of Rigorous Methods Can Help Identify Effective Interventions*, GAO-10-30 (Washington, D.C.: Nov. 23, 2009) and *Designing Evaluations: 2012 Revision*, GAO-12-208G (Washington, D.C.: Jan. 2012).

³⁶Office of Management and Budget, Circular A-4: *Regulatory Analysis*, September 17, 2003.

approving applications for small business loans or credit lines; the demand for small business loans; the participant's practices regarding approvals of loans and lines of credit for small business; use of SBLF funding or the type of actions the institution has taken because of SBLF funding; and outreach activities to minority, women, and veteran communities. Treasury also leveraged the Federal Reserve's Senior Loan Officer Opinion Survey on Bank Lending Practices as it developed questions for the survey and is exploring how it may analyze results from both surveys to assess SBLF. Responses were due from the SBLF participants by October 4, 2012. Treasury plans to issue the results in a report at a later date.

**Treasury Has Developed
Performance Indicators for
SSBCI**

In our December 2011 SSBCI report, we recommended that Treasury develop and finalize SSBCI-specific performance measures for evaluating the effectiveness of the program and when developing these measures consider key attributes of successful performance measures.³⁷ In response to the recommendation, Treasury developed measures for both the timeliness of program administration and program performance. In establishing measures on timeliness, Treasury considered its own role in administering the program, which includes evaluating the eligibility of the participating states and approving state programs; overseeing compliance with the provisions of the act, the SSBCI policy guidelines, and the terms and conditions of the Allocation Agreement; and providing ongoing technical assistance for each state's and municipality's program implementation. According to Treasury, the timeliness measures will assess the quality of the direction provided by Treasury to the states, including the efficiency of Treasury's administration of program resources and program oversight. These goals for these measures are

- 90 percent of requests for modifications to Allocation Agreements are approved or rejected within 90 days of receiving a final submission,
- 90 percent of requests for subsequent disbursements under existing Allocation Agreements are approved or rejected within 90 days of receipt of a formal submission, and
- 90 percent of quarterly reports received within 5 days of the deadline.

³⁷GAO-12-173.

According to Treasury staff, for the first two goals, the measurement period starts once Treasury has received all documentation required by the established procedures for each underlying activity from the state requesting a modification or disbursement. Treasury staff advised us that these measures are tracked continuously and that Treasury reports the 12-month data to the Office of Management and Budget annually as part of SSBCI's annual budget submission, which should be publicly available.

In addition, Treasury has developed measures for evaluating performance for SSBCI:

- amount of SSBCI funds used over time, as reported on SSBCI quarterly reports;
- volume and dollar amount of loans or investments supported by SSBCI funds, as reported on SSBCI annual report;
- amount, in dollars, of private-sector leverage in SSBCI annual reports; and
- estimated number of jobs created or retained in SSBCI annual reports.

Although Treasury has established measures for SSBCI performance, Treasury is considering how it will use these program performance indicators for evaluating the overall progress of SSBCI. Treasury staff recognized that performance indicators can help policymakers understand the results of the policy, but they emphasized that they do not have a full year of SSBCI data to use in evaluating the program. Many states did not receive their first SSBCI allocation until late 2011 and thus, Treasury had limited data to evaluate SSBCI. For example, Treasury told us that only 23 states reported using SSBCI funds to support small business loans or investments as of December 31, 2011. Treasury officials told us that after they have received the 2012 annual report data in early 2013, which would constitute a full year of SSBCI funds for almost all participants, they will be able to decide how they will review and analyze the performance measures going forward.

In addition, Treasury explained that SSBCI's performance cannot be evaluated using a single number or performance indicator because SSBCI consists of 140 different programs, and most states have multiple small business programs. For instance, Treasury has not created a specific number of estimated jobs as a target because so many factors can determine the use of funds—for example, the degree of interest by financial institutions and private investors, the performance of the state agency and any contractors that operate the approved program, and the

effectiveness of the program features designed by the state. How this program activity affects the level of employment in a state introduces many variables that can be difficult to predict. According to Treasury officials, specific numeric indicators, such as the number of loans resulting from state business programs, may or may not be indicative of the performance of SSBCI. In analyzing performance outcomes for SSBCI, Treasury staff advised us that outcomes are highly dependent on factors outside of the program's control, such as the demand for credit in a given locality and the quality of the small business borrowers' requests for such funds. Also, the states have different economies that may affect the results of the SSBCI funds. For example, Michigan's SSBCI funds are more concentrated in manufacturing, while other states may be more focused on providing assistance to small technological firms.

**Information on SSBCI
Performance Measures
May Be Useful for
Stakeholders**

In contrast to SBLF, the act does not require Treasury or the states and municipalities to report to Congress or the public on the status of SSBCI. Rather, the act requires that SSBCI participants include certain data, such as the number and the dollar amounts of the loans resulting from SSBCI funds, in annual reports to Treasury. Treasury's performance measures will rely on the data from these annual reports. Treasury officials told us that they are considering making public some of the SSBCI performance data, but have not decided what specific SSBCI information will be released publicly or how it will be presented because they want to make sure the information reflects the outcomes in an appropriate context. As noted earlier, SSBCI covers a large number of programs across the country and other factors, such as local demand for credit, could lead to different performance outcomes across the participating states. Officials told us they plan to decide after they receive and review the 2012 annual reports. The GPRA Modernization Act (GPRAMA) requires agency performance information to be publicly available.³⁸ In reporting on the governmentwide implementation of GPRAMA in 2011, we noted that agencies need to consider the differing needs of various stakeholders, including Congress, to ensure that performance information will be both useful and used.³⁹ We reported that federal officials must understand how

³⁸Pub. L. No. 111-352, 124 Stat. 3866 (2011).

³⁹See, GAO, *Managing for Results: GPRA Modernization Act Implementation Provides Important Opportunities to Address Government Challenges*, GAO-11-617T (Washington, D.C.: May 10, 2011).

the performance information they gather can be used to provide insight into the factors that impede or contribute to program successes; to assess the effect of the program; or to help explain the relationships between program inputs, activities, outputs, and outcomes.

Information on SSBCI's performance measures regarding the amount of small business loans or investments and the amount of private leveraging resulting from SSBCI funds would provide Congress and SSBCI participants with useful information on the progress of SSBCI and its effectiveness in increasing small business lending. For example, two states told us that they would like more information on the performance measures of the other states' programs in order to better implement their own programs. Making the 2012 performance outcome data publicly available may assist the participating states in identifying successful small business state programs and the level of private leveraging that the states have achieved at this point in the SSBCI program. SSBCI applications were required to demonstrate a reasonable expectation that the programs would achieve a 10:1 ratio of new small business lending to SSBCI funds within specified timeframes. Information on the progress of SSBCI programs may help participating states to make necessary adjustments to their programs to more efficiently and effectively use their entire allocation of SSBCI funds.

Treasury Has Taken
Actions to Enhance
Communications with
SBLF and SSBCI Program
Participants

SBLF

Treasury has taken steps to address our December 2011 recommendation that it apply lessons learned from the SBLF application review process in order to improve how it communicates with program participants and other stakeholders, such as the bank regulators and Congress.⁴⁰ In response to the recommendation, Treasury officials told us that they have enhanced their communication strategy with SBLF participants and stakeholders and that they are better positioned to

⁴⁰GAO-12-183.

respond to questions about SBLF. Shortly after the application review and approval period ended, Treasury assigned points of contact for each of the SBLF participants. Each point of contact was responsible for responding to inquiries from a designated group of participants and generally helping to ensure that the participants understood the compliance and reporting requirements. As the volume of inquiries has declined, Treasury shifted to a more centralized approach for handling inquiries. For example, all inquiries from SBLF participants are submitted to a centralized e-mail system, and they are then assigned to the staff responsible for (1) compliance, (2) investment management, and (3) operations. Compliance staff address questions about the Securities Purchase Agreements and the quarterly reports, and the reporting of qualified small business lending and the investment rates paid by SBLF participants. Investment management responds to inquiries relating to acquisitions and mergers and operations handle questions about redemption of SBLF shares and dividend payments. In addition, Treasury has assigned a staff member to handle external communications with Congress, the media, and the general public, including the reporting of qualified small business and the investment rates paid by SBLF participants. According to Treasury officials, they also communicate with industry and trade associations. Other communication methods established by Treasury included a webinar for instructing SBLF participants on completing the quarterly reports. Treasury staff told us that the purpose of the webinars was to reduce the number of errors in the quarterly reports.

In addition, on September 28, 2012, Treasury finalized written procedures to provide guidelines for answering inquiries to provide for consistency, continuity, and validity in communications with SBLF participants and their representatives. The guidelines describe the process by which a contact manager or staff member will communicate with SBLF participants. The process steps include the tracking and handling of incoming inquiries, outgoing mass communications, periodic reviews by business lines for potential Frequently Asked Questions, and the control manager's reviews of control effectiveness. The procedures outline the communication roles and responsibilities of SBLF employees, the contact manager, and management.

SSBCI

SSBCI has also developed communication mechanisms to assist states in developing and implementing their state small business programs. Treasury has assigned three relationship managers whose role is to work with an assigned group of states in successfully allocating the funds to lenders and subsequently to borrowers. Moreover, Treasury has assigned

a consultant for three states that requested additional technical expertise in implementing their small business programs. Additionally, according to Treasury officials, Treasury has engaged a consultant to assist in educating lenders nationwide about the approved state programs and two consultants to assist with expertise in state-run venture capital to support SSBCI staff in providing technical assistance to state program managers

In addition to the relationship managers and consultants, Treasury has held two conferences for communicating with SSBCI participants. Under the act, Treasury is generally required to disseminate best practices to the states, and Treasury staff view the conferences as one method of doing so. The *SSBCI National Standards for Compliance and Oversight* are another example of disseminating best practices. According to Treasury staff, conferences provide state officials with the opportunity to discuss their programs with peers that are running similar programs and can potentially make modifications to their applications. During the March 2012 conference, states received information on the different types of small business programs, lenders, and Treasury assistance. The conference agenda showed that several panels were held. Generally, the panels consisted of state officials, who discussed their small business programs, such as the Loan Participation Program and the Venture Capital Program. In addition, four banks participated in the panels. Training sessions were held during the conference on the National Compliance Standards, on requests for modifications to the Allocation Agreements, and on subsequent disbursement requests of SSBCI funds. Officials from two states we interviewed told us that they found the March 2012 conference helpful. For example, one official stated that she found the conference assisted her in answering questions on compliance and on SSBCI small business programs. Treasury held a similar conference in early October 2012.

Conclusions

SBLF and SSBCI officials have made progress in developing procedures to monitor participants' compliance. In response to our previous recommendation on SBLF monitoring, Treasury has developed procedures for monitoring SBLF participant compliance with legal and reporting requirements. Treasury also issued the standards for compliance to provide states with best practices for reviewing participants' compliance with SSBCI's legal and policy requirements and developed procedures for sampling transaction-level data to evaluate the accuracy of the states' annual reports.

Most SSBCI participants have only received the first of three disbursements of their full allocation approved by Treasury, and some participants were concerned that they may have difficulty using the funds in time to meet the requirements to get their third and final allocation within 2 years. SSBCI participants lack a clear understanding of what actions Treasury plans to take if they do not meet the 2-year time frame. Although a Treasury official has publicly indicated that Treasury does not currently plan to exercise the authority to terminate funds that have not been allocated within 2 years from the states' approval date, it retains the authority to do so in the future. Treasury has yet to develop a formal written policy or guidance explaining its position. Clear and specific guidelines on how Treasury plans to use this authority to terminate funds will help ensure Treasury is consistent in how it applies this authority and may further encourage participants to develop programs and approaches to use the funds in a timely manner. Moreover, such a policy could also facilitate the ongoing communication between Treasury and the participants on how best to allocate and use the funds.

Treasury has taken some steps to evaluate the performance of SBLF and the extent to which SBLF participants are increasing their small business lending, but further refinements could provide a better assessment of the effectiveness of SBLF. As we found in our December 2011 SBLF report, Treasury has yet to finalize plans for assessing the performance of the program, including measures that can isolate the impact of SBLF from other factors that affect small business lending. As we found in Treasury's analysis as well as our own, SBLF participants appear to be increasing their small business lending since entering the program. However, as we recommended in our 2011 report, many factors can contribute to such increases, and Treasury should assess these trends taking other factors into account. While Treasury compared SBLF participants to non-SBLF institutions and reported this analysis in its Use of Funds Report, it did not provide important information on why it selected the comparison group that it used rather than using a peer group more closely matched to the SBLF participants. Our own analysis using a peer group showed that SBLF participants had increased their lending compared to peers, but also showed that the difference in small business lending growth was somewhat smaller than what Treasury's analysis suggests. The lack of explanation for Treasury's approach in the Use of Funds Report could create confusion about the rigor of the comparison. Furthermore, a more transparent description of the methodological decisions would help to enhance the transparency of the information reported. In addition, as we recommended in the 2011 report, Treasury should include in its plans for assessing the program a more robust evaluation that controls for

factors that affect small business lending, such as improved local economic growth. Without such an evaluation, policymakers, including Congress, may not have the information they need to assess whether the SBLF approach of using capital injections is a desirable policy option for increasing small business lending. Furthermore, a more transparent description of the methodological decisions would help to enhance the transparency of the information reported.

In addition, as we recommended last year, Treasury has created performance indicators to help monitor and measure the effectiveness of SSBCI. However, Treasury has not yet determined how and when it will make this information public. Treasury officials acknowledged the importance of this information for policymakers and have said they hope to develop a method for sharing this information publicly after they have had time to review the second annual reports that will be completed by the states next year. While we recognize that it is still early in the program and results vary greatly across the program participants for a variety of reasons, performance information is an important tool for policymakers, particularly as Congress reviews and considers programs to assist small businesses going forward. In addition, making this information public in a timely manner may help program participants, who could observe how their peers are performing and use this information to help them improve their own programs.

Recommendations for Executive Action

We recommend that the Secretary of the Treasury take the following three actions:

- To help ensure that Treasury is transparent and accountable in its decision making, Treasury should develop a written policy explaining how it will use the Secretary's discretionary authority to terminate the availability of allocated funds to SSBCI participating states if funds have not been transferred to the participant by the end of the 2-year period beginning on the date that the Secretary approved the state for participation.
- To enhance the transparency of its reporting on SBLF, Treasury should expand its methodology discussion in its Use of Funds Report to include the rationale for its methodology and alternative methodologies it considered.
- To provide Congress and the participating states with information on the progress of SSBCI, Treasury should make information publicly

available on its performance indicators measuring SSBCI's performance.

Agency Comments and Our Evaluation

We provided a draft of this report to Treasury for review and comment. The Deputy Assistant Secretary for Small Business, Community Development, and Affordable Housing Policy provided written comments, which are reprinted in appendix II. Treasury also provided technical comments on the draft report, which we incorporated as appropriate. In the written comments, Treasury agreed with the three recommendations and stated that it has begun to take steps to implement each of them. Specifically, Treasury said it has begun to develop a written policy for exercising its discretion to terminate any portion of a state's allocation not yet transferred to the state after two years. Treasury said it also will include the rationale for Treasury's methodology along with alternative methodologies that were considered in the methodology section of the next Use of Funds Report and that work is underway on publishing performance indicators that measure SSBCI outcomes. Treasury noted that the report reflected the progress SBLF and SSBCI had made in setting up compliance procedures and taking steps to improve communication with program participants. Treasury also stated that both programs are working as intended and that it expects both programs to continue to promote lending to small businesses.

We are sending copies of this report to the appropriate congressional committees and Treasury. The report also is available at no charge on the GAO website at <http://www.gao.gov>. If you or your staff members have any questions about this report, please contact Daniel Garcia-Diaz at (202) 512-8678 or garciadiazd@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix III.



Daniel Garcia-Diaz
Acting Director
Financial Markets and Community Investment

List of Committees

The Honorable Debbie Stabenow
Chairwoman
The Honorable Pat Roberts
Ranking Member
Committee on Agriculture, Nutrition, and Forestry
United States Senate

The Honorable Daniel K. Inouye
Chairman
The Honorable Thad Cochran
Vice Chairman
Committee on Appropriations
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The Honorable Sam Graves
Chairman
The Honorable Nydia Velázquez
Ranking Member
Committee on Small Business
House of Representatives

The Honorable Dave Camp
Chairman
The Honorable Sander Levin
Ranking Member
Committee on Ways and Means
House of Representatives

Appendix I: Objectives, Scope, and Methodology

Our objectives were to examine: (1) the status of the U.S. Department of the Treasury's (Treasury) efforts to monitor participants' compliance with program requirements under the Small Business Lending Fund (SBLF) and the State Small Business Credit Initiative (SSBCI); (2) the status of SBLF and SSBCI participants' small business lending; and (3) the extent to which Treasury evaluates and communicates SBLF and SSBCI program outcomes.

To examine the status of Treasury's efforts to monitor participants' compliance with program requirements under SBLF and SSBCI, we analyzed Treasury's documentation. For SBLF, we reviewed and analyzed SBLF's *Participant Compliance Monitoring Procedures*, which were issued on September 28, 2012. We interviewed Treasury officials on their compliance program and the process by which staff review the Quarterly Supplemental Reports for their accuracy.

For SSBCI, we reviewed *SSBCI National Standards for Compliance and Oversight* and SSBCI Policy Guidelines. We reviewed the Allocation Agreements between Treasury and nine participating states that we interviewed to analyze the conditions and the requirements placed on the states. We interviewed Treasury officials on implementing the SSBCI compliance standards and officials from the states of Colorado, Florida, Georgia, Illinois, Massachusetts, Michigan, New Jersey, Oregon, and Texas. We judgmentally selected these nine states based on the following criteria: (1) the top 25 states awarded the most SSBCI funds; (2) geographical diversity; (3) states with at least two small business programs; (4) states that began using funds as of March 31, 2012, and states that had not yet used funds for any loans or investments as of March 31, 2012; and (5) avoiding states which have been reviewed previously by GAO or the Treasury's Office of the Inspector General. Because a large number of states had not spent their first allocation as of December 31, 2011, we used both the 2011 Annual Report and the Quarterly Report for March 31, 2012, to identify states' progress in allocating their funds. In terms of geographical diversity, we selected at

least two states from each of four regions: Midwest, Northeast, South, and West.¹

To determine the status of SBLF, we reviewed the SBLF Use of Funds Reports to determine the most current level of qualified small business lending and the distribution of dividend or interest rates paid by program participants. Because Treasury requires only SBLF participants to submit data on qualified small business lending—generally, lending below \$10 million—we also analyzed total business lending as well as small business loans under \$1 million, which is available through the Call Reports.² We accessed the Call Report data using SNL Financial—a private financial database that contains publicly filed regulatory and financial reports—and analyzed lending by SBLF participants for the quarter ending June 30, 2012. The Small Business Jobs Act of 2010 (the act) establishes the baseline for measuring the change in small business lending as the average of the amounts that were reported for each of the four calendar quarters ended June 30, 2010. Call Reports did not begin requiring quarterly reporting of small business loans under \$1 million until the second quarter of this four quarter baseline period. Accordingly, we calculated the baseline for small business loans under \$1 million using the average of each of the three calendar quarters ended June 30, 2010. The act also defines one of the categories of qualified small business lending as owner-occupied nonfarm, nonresidential real estate loans. For quarterly reports of small business lending, Call Reports use a broader category of all nonfarm, nonresidential real estate without a distinction for owner occupancy. As a result, the small business loans under \$1 million include the broader category. The total business lending numbers use the full baseline and the narrower categorization of owner-occupied nonfarm, nonresidential real estate and should therefore not be compared to the

¹The Midwest region includes: Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota, and Wisconsin. The Northeast region includes: Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, and Pennsylvania. The South region includes: Alabama, Arkansas, Delaware, District of Columbia, Florida, Georgia, Kentucky, Louisiana, Maryland, Mississippi, North Carolina, Oklahoma, South Carolina, Tennessee, Texas, Virginia, and West Virginia. The West region includes: Arizona, California, Colorado, Idaho, Montana, Nevada, Utah, Oregon, Washington, and Wyoming.

²Call Reports require reporting only on loans up to \$500,000 for two of the loan categories—loans to finance agricultural production and loans secured by farmland. The \$1 million threshold still applies to the other two categories—commercial and industrial loans and nonfarm, nonresidential real estate loans.

numbers for small business loans under \$1 million. We assessed the reliability of these data, for example, by analyzing missing data and performing various logic tests and determined that the data were sufficiently reliable for the purpose of reporting on SBLF lending.

To review SSBCI participants' small business lending, we collected and reviewed data from the Quarterly Report as of June 30, 2012—the most recent quarter available. We conducted data reliability checks on the SSBCI quarterly data for the dollar amounts transferred to the states and the dollar amounts used by each participating state to identify any potential discrepancies in the data. We interviewed Treasury officials on how they assessed these data. In addition, we verified with three states the data that they had sent to Treasury on the SSBCI Quarterly Report as of June 30, 2012. We also interviewed state and Treasury officials about the status of the use of SSBCI funds and Treasury's authority to suspend disbursements to SSBCI participants. Based on these steps, we determined that the data collected by Treasury for SSBCI were sufficiently reliable for the purpose of reporting total amounts of funds allocated and used by the states.

To examine the extent to which Treasury evaluates and communicates SBLF and SSBCI program outcomes, we reviewed Treasury documentation for both programs. For determining the extent to which Treasury evaluates the performance of SBLF, we reviewed the Use of Funds Report to evaluate the methodology Treasury used to assess the performance of SBLF participants against a comparison group of institutions that did not participate in SBLF. We interviewed Treasury officials to understand the process for developing the comparison group as well as the alternatives they considered. We used the methodology in the report to replicate Treasury's group for our analysis. To help understand the usefulness of the comparison group, we also chose a peer group of non-SBLF institutions that we adjusted for geographical and size distribution as well as financial health, using the Texas Ratio as a proxy.³ To select the peer group, we started with our replication of Treasury's comparison group of 6,175 institutions and categorized them

³The Texas Ratio is defined as nonperforming assets plus loans 90 or more days past due divided by tangible equity and reserves. It helps determine a bank's likelihood of failure by comparing its troubled loans to its capital. Because SBLF funding increases the equity portion of the ratio, we used Texas Ratios as of March 31, 2011, which was the last quarter preceding the initial disbursements of SBLF funding.

into six asset-size groups. We then sorted the institutions by state, asset group, and Texas Ratio and generally assigned two peer institutions to each SBLF participant with the closest Texas Ratios, within the same state and asset group. In some cases, we had to make judgments in choosing the peers—for example, when two SBLF participants were similar to one another and when too few potential peers existed. We determined that any potential judgment factors were mitigated by the fact that the peer group mirrored the SBLF more closely than the comparison group across geographical and size distribution as well as financial health (see table 1). Consistent with the Use of Funds Report, we analyzed the growth in total business lending because qualified small business lending data were not available for non-SBLF institutions and because qualified small business lending totaled 95 percent of total business lending for the median SBLF participant as of December 31, 2011. Here we calculated the baseline using the average of the four quarters ending June 30, 2010. The data limitation mentioned earlier that required us to use only three quarters in the calculation of the baseline only applied to the availability of small business lending data, and the three-quarter baseline was used only in those earlier sections. We compared our peer group with Treasury's comparison group and compared both to SBLF participants. We also compared Treasury's analysis against our previous work on program evaluation as well as best practices identified by the Office of Management and Budget. In assessing the SBLF communication process, we reviewed and analyzed SBLF's Contact Management Procedures and interviewed Treasury officials on how they communicated with SBLF participants.

Table 1: Summary Data on SBLF Participants, GAO's Peer Group, and Treasury's Comparison Group

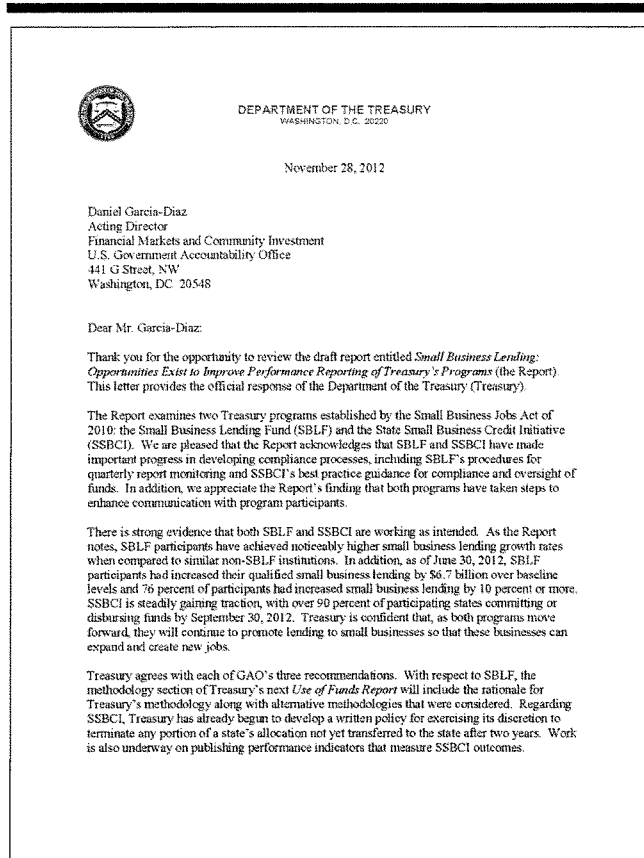
	SBLF participants	GAO peer group	Treasury comparison group
Number of institutions	267	503	6,175
Small business lending growth, under \$1 million (median)	14.4%	N/A	N/A
Total business lending growth (median)	31.0%	6.1%	2.2%
Assets (median)	\$356,082	\$356,687	\$155,354
Texas Ratio (median)	15.74	17.29	18.21
Southeast	23%	23%	19%
West	12%	11%	7%
Southwest	15%	15%	16%
Northeast	6%	6%	3%
Mid-Atlantic	15%	15%	7%
Midwest	29%	31%	48%

Source: GAO analysis of Treasury and SBLF data.

For determining the extent to which Treasury evaluates SSBCI performance outcomes, we collected and reviewed the performance measures that Treasury developed for evaluating SSBCI. We interviewed Treasury officials on how they were planning to use the performance outcome measures in evaluating SSBCI. We also interviewed officials from the same nine states we described earlier—Colorado, Florida, Georgia, Illinois, Massachusetts, Michigan, New Jersey, Oregon, and Texas—to collect information on their evaluation and the performance information they reviewed relating to SSBCI. To analyze the communication of SSBCI performance outcomes, we reviewed the relevant provisions of the Small Business Jobs Act of 2010 and Treasury's outreach information that they had drafted for the states, such as conference materials.

We conducted this performance audit from March 2012 to December 2012 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Comments from the Department of the Treasury



Appendix II: Comments from the Department
of the Treasury

Thank you once again for the opportunity to review the Report. Treasury values GAO's review of these programs and looks forward to continuing to work with your team.

Sincerely,



Don Graves, Jr.
Deputy Assistant Secretary for Small Business,
Community Development, and Affordable Housing
Policy

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

Daniel Garcia-Diaz, (202)-512-8678, garciadiazd@gao.gov

Staff Acknowledgments

In addition to the individual named above, Kay Kuhlman (Assistant Director), Pamela Davidson, Nancy Eibeck, Chris Forys, Michael Hoffman, Jonathan Kucskar, Marc Molino, Jennifer Schwartz, and Jena Sinkfield made key contributions to this report.

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Opening Statement

Rep. Elijah E. Cummings, Ranking Member

Hearing on "Broken Promises:

The Small Business Lending Fund's Backdoor Bank Bailout"

April 24, 2013

Thank you, Mr. Chairman. And thank you, Ms. Romero, for testifying here before us today. We appreciate your service, and we thank you and everyone in your office for the work that you do.

Small businesses are the lifeblood of our country's economy. When small businesses thrive, America thrives. When small businesses have access to credit, they hire more workers, and they replenish their inventories.

This was the rationale behind the passage of the Small Business Jobs Act of 2010. In order to help small banks increase their lending to small businesses, Congress created the Small Business Lending Fund as an investment in America's future.

Since the inception of this program in 2011, it has been a marked success. Lending to small businesses has increased by \$8.9 billion, which translates to more than 38,000 new loans to small businesses. More than 80% of these loans are for less than \$250,000, and they are making a critical difference to a host of very small, but very important businesses.

My home state of Maryland has benefitted greatly from this program. Participating banks have increased their loans to small businesses by more than \$280 million. I am proud to think of the number of family-owned restaurants, florists, and daycare centers that are thriving with these loans.

The Chairman's home state of California is also benefiting from this program. California's small community banks participating in the program have increased their lending to small businesses by more than \$590 million.

The fact is that the entire country is benefiting from this program, particularly in the Southeast, where more than 11,000 small businesses have received loans, and in the Chairman's region in the Southwest, where 9,500 small businesses have received new loans.

Today, we will hear about a report issued by the Special Inspector General for TARP that is critical of this program because it allows financial institutions to essentially refinance some of their TARP funds with funds from this small business loan program.

We have to keep in mind, however, that this is exactly what Congress authorized in 2010 when we created this program. We wanted to incentivize banks to make loans to small businesses across the country in order to spur growth and help lift our economy out of the recession.

And the bottom-line is that the program is working. All of the banks are making their interest payments to the Treasury Department, and not one has missed a payment. In fact, Treasury now estimates that these investments will be repaid fully—along with a \$50 million profit to the American taxpayers.

Although I appreciate SIGTARP's work, today's hearing would have been more helpful to Committee Members if we could have heard from additional witnesses. For example, Treasury officials should be here to offer their response, but they were given only eight days notice, and they could not complete their testimony in that short timeframe. For this reason, Mr. Chairman, I ask that a letter sent on March 28, 2013, from Deputy Assistant Treasury Secretary Don Graves, responding to SIGTARP's report, be entered into the record.

I also think Committee Members would have benefited from hearing from the Special Deputy Inspector General at Treasury who has direct oversight jurisdiction over this program and has issued reports that appear to conflict with some of SIGTARP's findings. My staff contacted the Deputy IG, but she also was unavailable to attend this hearing on such short notice. For this reason, Mr. Chairman, I ask that the IG's report on this program, which was issued in July 2012, also be entered into the record.

Finally, GAO also has a statutory mandate to review this program and issue reports, and those reports have commended the implementation of this program. Unfortunately, we do not have anyone here from GAO either. I ask unanimous consent that GAO's reports on this program, which were issued in 2011 and 2012, also be entered into the record.

So, I look forward to the testimony of Ms. Romero, but what we will hear today is a partial and incomplete assessment of this program. I hope the Chairman will entertain requests for additional witnesses should the topic arise in the future.

Contact: Jennifer Hoffman, Press Secretary, (202) 226-5181.

Statement for the Record
House Committee on Oversight & Government Reform
Full Committee Hearing
“Broken Promises: the Small Business Lending Fund’s Backdoor Bank Bailout”
April 24, 2013
Congressman Michael R. Turner (OH-10)

Mr. Chairman, today’s hearing continues our Committee’s important work to investigate waste, fraud, and abuse in the federal government. The topic of discussion today, the Small Business Lending Fund (SBLF), was created by the Democrat-controlled House as part of the so-called “Small Business Jobs Act of 2010” with the stated goal of increasing “the availability of credit to small businesses.” However, the resulting program was simply a slush fund for bailed-out banks to use in avoiding repayment of their debts to the taxpayer.

As some of our colleagues stated during debate on the bill that created this \$30 billion account, the SBLF was no more than another unwise, taxpayer-funded bailout – “this is TARP, plain and simple” as now-Chairman of the Financial Services Committee, Mr. Hensarling, described it at the time. Moreover, we saw strong opposition by Democrats and the Administration as to placing responsibility for oversight of the SBLF with the Special Inspector General for the Troubled Asset Relief Program (SIGTARP). However, we are here today because, at least in part, of the failures of the Treasury Department to properly administer the SBLF and using it to let TARP recipients off the hook.

As noted in the SIGTARP audit entitled *Banks that Used the Small Business Lending Fund to Exit TARP*, two-thirds of the \$4 billion disbursed by Treasury from the SBLF went to TARP banks. Rather than using those funds to create jobs or institute a meaningful expansion of small business lending, Treasury allowed these TARP banks to use eighty percent of their SBLF funds to pay-off – or more accurately, refinance – the debts they owed to taxpayers under TARP. The lower interest rates for the SBLF when compared to the interest rates of TARP, as well as the absence of restrictions on luxury expenditures, executive compensation, and governance in the SBLF allowed bailed-out banks to skirt oversight safeguards in TARP and short change the taxpayer on their debt.

Mr. Chairman, thank you for holding this important hearing today to examine this clear mismanagement of taxpayer dollars and to hear from SIGTARP experts on the failures of the Treasury Department in administering this multi-billion dollar bailout. I would also like to thank Christy Romero, the Special Inspector General for TARP and our witness here today, for her continued work on behalf of the American people to bring accountability and transparency to these programs.

Broken Promises: The Small Business Lending Fund's Backdoor Bank Bailout
Committee on Oversight and Government Reform
Congressman Cárdenas
Wednesday, April 24, 2013

Thank you Chairman Issa and Ranking Member Cummings for calling this important hearing today to discuss the benefits and shortfalls of the Department of Treasury's Small Business Lending Fund (SBLF) and the steps we can take to ensure that small businesses have access to the capital they need to stay competitive, expand, and create jobs.

Everyone understands that growing our small business sector is critical to our economic recovery and fostering a vibrant and strong economy in the long-term. Small businesses are some of our best innovators and biggest job creators in our country and provide millions of workers with their livelihoods.

In 2010, Congress passed the Small Business Jobs Act. This bill sought to stimulate job growth through the creation of the Small Business Lending Fund. This program directed the Treasury to invest up to \$30 billion in small banks so they could in turn provide financing to small businesses at lower rates. This bill was intended to boost lending so that small businesses could access the capital they needed to expand their operations, hire new workers, and remain afloat during one of the worst economic times in recent history.

A study conducted by the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) earlier this month showed that merely \$4 billion out of the \$30 billion available for SBLF was invested by the Treasury. I am intrigued by the fact that two-thirds of this money (\$2.7 billion) went to 132 Troubled Asset Relief Program (TARP) banks, which used \$2.1 billion (80% of SBLF money) to exit TARP.

A major problem highlighted by the SIGTARP study is that the lending plans submitted by applicant banks were not fully assessed and evaluated by Treasury; it would seem to me that these plans played little part in the decision of whether a bank should or should not receive SBLF funds. According to the study, these plans were used to check-the-box and both the Treasury and banking regulators assumed the other was responsible of evaluating them.

However last December, the Government Accountability Office (GAO) released a comprehensive report of SBLF and its conclusions are far more positive than SIGTARP's findings. The GAO concluded that in fact SBLF participants had increased their business lending over the 2010 baseline and that the median participants had a 14 percent increase for small business loans under \$1 million.

Additionally, the Treasury responded to the SIGTARP study and strongly challenged its findings stressing that the reason why banks that had received TARP funds were able to refinance out of those programs and into SBLF was because Congress mandated it.

We clearly do not have the entire picture before us. I am disappointed that the Treasury Department and its office of oversight for SBLF are not here today to testify and shed light on the matter. I understand that they were not given enough advance notice to send a witness. However, it would have been helpful for understanding the full scope of accomplishments or shortfalls of this program.

As a former small business owner myself, I understand the difficulties and challenges that small business owners face when managing their businesses, especially in financially during trying times when capital is unavailable or extremely expensive.

I represent many of these small business owners – restaurants, construction companies, corner stores, manufacturers of parts and components – who are struggling to make ends meet and stretch every dollar to keep their businesses afloat.

Staying afloat is especially important to many minority and women business owners who depend on their businesses to make a living and whose entire life savings are tied to their business' success. This is why we should ensure that the taxpayer dollars that we have committed to SBLF are actually increasing access to capital for small businesses.

Although SBLF is not a TARP program and all points of view are not represented today, I look forward to hearing Honorable Romero's testimony. I hope that Treasury will be given an opportunity to respond and address the concerns raised during this hearing at a later time.

Lastly, I want to reiterate the significant role small businesses play in our economy and I want to make sure we are doing everything possible to help them thrive and push our economy into full recovery.



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April 23, 2013

The Honorable Darryl Issa	The Honorable Elijah Cummings
Chairman	Ranking Member
Committee on Oversight and Government Reform	Committee on Oversight and Government Reform
United States House of Representatives	United States House of Representatives
Washington, DC 20515	Washington, DC 20515

Dear Chairman Issa and Ranking Member Cummings,

On behalf of the Credit Union National Association (CUNA), I am writing regarding the hearing the Committee will hold later this week entitled, "Broken Promises: The Small Business Lending Fund's Backdoor Bank Bailout." CUNA is the largest credit union advocacy association in the United States, representing nearly 90 percent of America's 7,000 state and federally chartered credit unions and their 96 million members. We appreciate your holding this timely and important hearing.

In 2010, banks and their national trade associations vigorously pushed for enactment of H.R. 5297, the Small Business Lending Fund (SBLF) Act. To this day, despite numerous negative government reports and news coverage, these same supporters in the banking community have yet to admit the obvious fact that the fund created by this Act has done little to stimulate bank lending to small business but has allowed more than 100 banks to use SBLF funds to repay, on better terms, the funds they received from the American taxpayer through the Troubled Asset Relief Program (TARP). In other words, the SBLF (Bank Bailout 2.0) was a sweetheart deal to further assist banks that were aided in TARP (Bank Bailout 1.0).

Earlier this month, the Treasury Department released a report regarding the implementation of the Small Business Jobs Act and the Small Business Lending Fund. The report states:

"In total, 137 institutions [banks] repaid a CPP [Capital Purchase Program, TARP] investment in connection with an SBLF closing. These banks received \$2.7 billion in SBLF funding and used \$2.2 billion of this capital to repay outstanding CPP balances."¹

On April 9, 2013, the Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) released a report that echoes the Treasury report. SIGTARP noted that:



¹ Department of Treasury. "Use of Funds Report -- Report to Congress submitted pursuant to Section 4106(3) of the Small Business Jobs Act." April 2013. 9.

The Honorable Darryl Issa
The Honorable Elijah Cummings
April 23, 2013
Page Two

“Treasury invested only \$4 billion of the \$30 billion available – two-thirds of which (\$2.7 billion) went to 137 TARP banks that used \$2.1 billion in SBLF funds to exit TARP in 2011... The 132 of 137 former TARP banks remaining in SBLF have not effectively increased small-business lending because they used approximately 80% of SBLF funds (\$2.1 billion of the \$2.7 billion) to repay TARP.”²

SIGTARP went on the recommend:

“To preserve the amount of capital former TARP banks participating in SBLF have to lend, the primary Federal banking regulators (the Federal Reserve, FDIC, or OCC) should not approve dividend distributions to common shareholders of former TARP banks that have not effectively increased small-business lending while in SBLF.”³

It is important not to forget that the SBLF was strongly promoted by both the American Bankers Association (ABA) and the Independent Community Bankers of America (ICBA) as a way for their member banks to promote bank lending to small business and jumpstart economic recovery.

On May 18, 2010, ICBA testified before the House Financial Services Committee that the association “strongly supports the new SBLF proposal and we’ll do our part to make it a success.”⁴ The American Bankers Association also gave their endorsement of the legislation in a statement for the record of the hearing, emphatically stating:

“ABA supports H.R. 5297, the Small Business Lending Fund Act of 2010, which was recently proposed to stimulate small business lending. This bill can help community banks meet the needs of small businesses across America.”⁵

Have community banks met these needs? The answer is obviously “no.”

² Special Inspector General for the Troubled Asset Relief Program. “Banks that Used the Small Business Lending Fund to Exit TARP.” April 9, 2013. 2, 6.

³ Ibid. 20.

⁴ Testimony of James D. MacPhee, Chief Executive Officer of Kalamazoo County State Bank in Schoolcraft, Michigan, on behalf of the ICBA, before the House Committee on Financial Services hearing entitled, “Initiatives to Promote Small Business Lending, Jobs and Economic Growth.” May 18, 2010. 6.

⁵ Statement of the American Bankers Association for the record of the House Committee on Financial Services hearing entitled, “Initiatives to Promote Small Business Lending, Jobs and Economic Growth.” May 18, 2010. 2.

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The Honorable Elijah Cummings
April 23, 2013
Page Three

To put these past statements and their current silence on the dismal failure of the SBLF in context, it is important to take a look at the banking industry's performance. In the fourth quarter of 2012, America's banks reported net income of \$34.7 billion, an increase of \$9.3 billion (37%) from a year earlier. Eighty-six percent of banks made a profit in the fourth quarter. According to the American Bankers Association, bank revenue increased from the previous year, in part due to a \$10 billion (18%) increase in noninterest income on gains of loan sales and increased trading revenue.⁶ Banks are clearly in excellent financial condition but have ignored small business lending and have chosen instead to use Bank Bailout 2.0 to cheaply pay off their obligations from Bank Bailout 1.0.

Credit unions were not eligible to participate in the SBLF and, frankly, did not need a taxpayer fund to encourage them to lend to their small business members. As we noted during the consideration of the SBLF, there was – and still is – a better way to stimulate lending to America's small businesses and it doesn't cost the taxpayers a dime. The Credit Union Small Business Jobs Creation Act (H.R. 688) would permit credit unions to more fully meet the credit needs of America's small businesses by increasing the statutory credit union member business lending cap. If enacted, we estimate that credit unions could lend an additional \$13 billion to small businesses in the first year, helping them to create more than 140,000 new jobs.

We know the banks oppose H.R. 688; but considering how they have used the taxpayer-subsidized SBLF, their opposition to this legislation is a pretty good reason to support it. Moreover, credit unions' performance in small business lending during the crisis – when they expanded their offerings 45% while bank small business offering contracted 15% -- should speak volumes of what small business should expect if Congress allows credit unions to continue to lend to them. Credit unions were there for small businesses when the banks, with taxpayer backing, abandoned them; and if Congress permits it, credit unions will continue to be there for small businesses during the recovery.

America's credit unions and their 96 million members stand ready to continue to be part of the solution to the economic problems our nation faces. We encourage all Representatives to cosponsor H.R. 688, and hope the House will act quickly to pass this bill.

Best regards,



Bill Cheney
President & CEO

⁶ <http://www.aba.com/Members/Research/Documents/ConditionsoftheIndustry.pdf>



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April 23, 2013

The Honorable Darrell Issa
Chairman
House Committee on Oversight &
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U.S. House of Representatives
Washington, D.C. 20515

The Honorable Elijah Cummings
Ranking Member
House Committee on Oversight &
Government Reform
U.S. House of Representatives
Washington, D.C. 20515

Re: Credit unions want to help small business, even when banks don't

Dear Chairman Issa and Ranking Member Cummings:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association exclusively representing the interests of our nation's federally chartered credit unions, I write today in advance of tomorrow's hearing, "Broken Promises: The Small Business Lending Fund's Backdoor Bank Bailout." As recently detailed by the Special Inspector General for TARP, the Small Business Lending Fund for community banks intended to spur lending and create jobs fell painfully short. While the banking industry continues to rely on taxpayer funds while not helping small business, credit unions and their 95 million members stand ready to help ensure small businesses can access the capital they need – while not taking taxpayer money to do so.

As recently released by the Special Inspector General for TARP and subsequently reported in *The Wall Street Journal*, out of the 332 banks participating in the small business lending fund program run by the Treasury Department, 137 used more than half of about \$4 billion disbursed by the program to help fund their exits from the Troubled Asset Relief Program. It was also found that a sizeable number of these banks didn't increase lending at all. Christy Romero, special inspector general for TARP, said it best, stating, "Small-business loan levels by TARP banks in [the] Small Business Lending Fund came up short." While the banks are waiting for the next taxpayer giveaway, credit unions continue to do what they have always done – serve those within their field of membership who may otherwise be unbanked.

As you know, bipartisan legislation (H.R. 688) put forward by Reps. Ed Royce (R-CA) and Carolyn McCarthy (D-NY) would raise the arbitrary member business lending cap for those credit unions meeting strict eligibility requirements. Restricting credit unions on the amount of business lending they can facilitate is counterproductive to job creation and should be addressed

immediately. For over 80 years credit unions conducted safe and sound business lending activity without the existence of any cap at all. In addition to this proven track record, the Treasury Department and the National Credit Union Administration (NCUA) have signed-off on this common sense proposal that would create jobs. Contrary to Small Business Lending Fund for community banks, raising the credit union member business lending cap wouldn't spend a single dime of taxpayer funds.

We thank you for your consideration and welcome the opportunity to discuss this matter further. If my colleagues and I can be of assistance to you, or if you have any questions regarding this issue, please feel free to contact myself or NAFCU's Senior Associate Director of Legislative Affairs, Jillian Pevo, at (703) 842-2286 or JPevo@nafcu.org.

Sincerely,



Brad Thaler
Vice President of Legislative Affairs

cc: Members of the House Committee on Oversight and Government Reform