



# Banks that Used the Small Business Lending Fund To Exit TARP

Special Inspector General for the Troubled Asset Relief Program



**OFFICE OF THE SPECIAL INSPECTOR GENERAL**  
**FOR THE TROUBLED ASSET RELIEF PROGRAM**  
1801 L STREET, NW, 4<sup>TH</sup> FLOOR  
WASHINGTON, D.C. 20220

April 9, 2013

MEMORANDUM FOR: The Honorable Jacob J. Lew – Secretary of the Treasury  
  
The Honorable Thomas J. Curry – Comptroller of the Currency  
  
The Honorable Martin J. Gruenberg – Chairman, Board of Directors of the Federal Deposit Insurance Corporation  
  
The Honorable Ben S. Bernanke – Chairman, Board of Governors of the Federal Reserve System

FROM: The Honorable Christy L. Romero – Special Inspector General for the Troubled Asset Relief Program

SUBJECT: Banks that Used the Small Business Lending Fund To Exit TARP (SIGTARP 13-002)

We are providing this report for your information and use. It discusses the small banks that exited the Troubled Asset Relief Program through the Small Business Lending Fund program.

The Office of the Special Inspector General for the Troubled Asset Relief Program conducted this audit (engagement code 026) under the authority of Public Law 110-343, as amended, which also incorporates the duties and responsibilities of inspectors general under the Inspector General Act of 1978, as amended.

We considered comments from the Department of the Treasury, the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency when preparing the report. Treasury's comments, along with those of the Federal banking regulators, are addressed in the report, where applicable, and a copy of the Treasury, Federal Reserve Board, Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency responses are included in the Management Comments section in Appendix D.

We appreciate the courtesies extended to our staff. For additional information on this report, please contact Mr. Bruce S. Gimbel, Acting Assistant Deputy Special Inspector General for Audit and Evaluation ([Bruce.Gimbel@treasury.gov](mailto:Bruce.Gimbel@treasury.gov) / 202-927-8978).



## Summary

On September 27, 2010, Congress created the Small Business Lending Fund (“SBLF”) as part of the Small Business Jobs Act of 2010, which permitted Treasury to invest up to \$30 billion in eligible small banks to increase “the availability of credit for small businesses.” Unlike the Troubled Asset Relief Program (“TARP”), SBLF incentivized lending by rewarding increases in lending with lower rates that a bank would pay the Government for the use of the money (known as the dividend rate).

The scope and scale of SBLF were not as expected, with most of the money going to banks already in TARP. 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.

As part of the Office of the Special Inspector General for the Troubled Asset Relief Program’s (“SIGTARP”) continuing oversight of TARP, SIGTARP conducted this review to determine whether Treasury and regulators consistently evaluated applications submitted by TARP banks to refinance into SBLF.

## What SIGTARP Found

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. Although Congress allowed TARP banks to participate, Congress intended that the banks would increase their loans to small businesses, and as a safeguard, required that applicant banks submit to their Federal banking regulator a “small business lending plan” detailing how the bank would increase lending.

However, former TARP banks in SBLF have not effectively increased small-business lending and are significantly underperforming compared to non-TARP banks. Twenty-four former TARP banks have not increased their lending. The remaining former TARP banks have increased lending by \$1.13 for each SBLF dollar they received. 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.

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. 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. TARP banks that received only enough SBLF funds to repay TARP have lent out significantly less than they received in SBLF funds – increasing lending by only 25¢ for each \$1 in SBLF funds. TARP banks that received additional SBLF money beyond the outstanding TARP balance have increased lending by \$1.67 for every \$1 in SBLF funds. 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.

Congress’ safeguard of requiring that banks submit a small-business lending plan did not have the intended effect because Treasury and the Federal banking regulators – Federal Reserve Board (“Federal Reserve”), Federal Deposit Insurance Corporation (“FDIC”), and Office of the Comptroller of the Currency (“OCC”) – did not adequately assess whether the banks’ plans to increase small-business lending were achievable – they did not focus on whether the TARP banks were prepared to lend SBLF capital. SIGTARP found that Treasury and the Federal banking regulators did not effectively communicate with each other, each claiming that the other had responsibility to assess the banks’ lending plans. Treasury’s SBLF program director told SIGTARP that Treasury did not perform an independent analysis of the projections in the lending plans, and that analysis of the lending plans was the regulators’ responsibility because the law required that the lending plans be submitted to regulators. Regulators did not agree with Treasury’s view.

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. Regulators did not consistently take action to preserve the intent of Congress by meaningfully



reviewing the banks' proposals to increase lending. Instead, regulators generally focused on the banks' viability, in a process described by one regulator as "left over" from TARP. Treasury's review of the lending plans was superficial, merely filling in a "check-the-box" review form, 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. Treasury and regulators did not deny SBLF funding to any TARP bank based on its lending plan.

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.

By not developing and implementing meaningful SBLF application review procedures that would achieve the intended purpose of promoting lending, 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.

### What SIGTARP Recommended

SIGTARP recommended: (1) that Treasury and the Federal banking regulators improve coordination when collaborating on current and future initiatives; (2) to increase small-business lending by former TARP banks participating in SBLF, Treasury should work with the banks to establish new, achievable plans to increase lending going forward; and (3) 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.

Treasury, FDIC, the Federal Reserve, and OCC provided official written responses, which are reproduced in full in Appendix D. A discussion of these responses and SIGTARP's response can be found in the Management Comments and SIGTARP's Responses section of this report.



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## Background

*This report discusses how, in 2011, 137 of the small banks bailed out by TARP used more than \$2 billion from another Government program, the Small Business Lending Fund, to repay and exit TARP.<sup>1</sup>*

In the wake of the financial crisis, the amount of credit available to small businesses declined substantially. According to Federal Deposit Insurance Corporation (“FDIC”) data, the total dollar amount of outstanding small-business loans dropped by nearly 15% between mid-2008 and mid-2011. The Troubled Asset Relief Program’s (“TARP”) bank program, called the Capital Purchase Program (“CPP”) was designed in part to address the decline in lending. From October 2008 through December 2009, the U.S. Department of the Treasury (“Treasury”) invested \$204.9 billion into 707 banks to “stabilize and strengthen the U.S. financial system by increasing the capital base of healthy, viable institutions, enabling them [to] lend to consumers and business[es].” Although a goal of the TARP bank program was to provide money to enable the banks to lend, Treasury did not require, or even incentivize, the banks to lend the TARP funds. A study published by the Small Business Administration found that from 2008 to 2011, TARP banks decreased their small-business lending even more than non-TARP banks.<sup>2</sup>

On September 27, 2010, Congress created the Small Business Lending Fund (“SBLF”) as part of the Small Business Jobs Act of 2010 (“Jobs Act”), which permitted Treasury to invest up to \$30 billion through this new program in eligible small banks to increase “the availability of credit for small businesses.”<sup>3</sup> To ensure that this lending objective was achieved, Congress required that all applicants submit a small-business lending plan addressing how they would increase small businesses lending. Unlike TARP, SBLF incentivized lending by

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<sup>1</sup> Many of the larger banks exited the Troubled Asset Relief Program (“TARP”) as soon as they were able to obtain regulatory approval to repay. For a detailed report of the circumstance surrounding the largest banks’ exits from TARP, see SIGTARP’s report, “Exiting TARP: Repayments by the Largest Financial Institutions,” published on September 29, 2011, at [www.sig tarp.gov/Audit%20Reports/Exiting\\_TARP\\_Repayments\\_by\\_the\\_Largest\\_Financial\\_Institutions.pdf](http://www.sig tarp.gov/Audit%20Reports/Exiting_TARP_Repayments_by_the_Largest_Financial_Institutions.pdf). Of the 137 institutions that exited TARP through the Small Business Lending Fund (“SBLF”), 132 remained in SBLF through the program’s most recent reporting cycle ending September 30, 2012, the latest data available. Five of the original 137 institutions paid back Treasury subsequent to entering SBLF.

<sup>2</sup> A November 2012 report developed under a contract with the Small Business Administration titled “How Did the Financial Crisis Affect Small Business Lending in the United States?” states, “During the financial crisis, small business lending declined by \$117 billion, or almost 18%, to only \$543 billion in 2011.” The report continues, “At TARP banks, small-business lending declined by \$74 billion, or 21% from 2008 – 2011 whereas at non-TARP banks, the decline was only \$42 billion, or 14%.”

<sup>3</sup> The Jobs Act limited participation in SBLF to banks with \$10 billion or less in assets at the end of 2009. Banks with \$1 billion or less in assets could apply to receive up to 5% of their risk-weighted assets, while those with more than \$1 billion and less than or equal to \$10 billion in assets could receive up to 3%. As with TARP’s bank programs, Treasury invested by purchasing preferred stock or other instruments in the bank.

rewarding increases in lending with lower rates that a bank would pay the Government for the use of the money (known as the dividend rate).<sup>4</sup> Senators discussed on the Senate floor how SBLF was “filling a gap” or was a “fix” to TARP because TARP did not contain requirements or incentives to lend.

The scope and scale of SBLF were not as expected, with most of the money going to banks already in TARP. In 2011, Treasury invested only \$4 billion of the \$30 billion available – two-thirds of which (\$2.7 billion) went to 137 TARP banks that used approximately \$2.1 billion in SBLF funds to exit TARP.<sup>5</sup> On October 18, 2011, then-Treasury Secretary Timothy F. Geithner testified before the Senate Committee on Small Business and Entrepreneurship that there was “a good case” for Congress allowing banks to refinance their TARP money with SBLF funds “because the capital they got [in] this program comes with a better incentive to use it to lend.”

Several members of Congress voiced concerns that the program could serve as a vehicle for TARP recipients to refinance into SBLF under more favorable terms with little resulting benefit for small businesses. TARP banks paying a dividend rate of 5% that transferred into the SBLF program had the potential to lower their dividend rate to 1% if they increased lending.<sup>6</sup> In addition, the SBLF dividend is non-cumulative, meaning that participants have no obligation to make quarterly payments as scheduled or catch up on missed payments, compared to TARP dividends, which generally are cumulative. TARP banks that used SBLF to exit TARP also benefited from a removal of restrictions that existed in TARP but not in SBLF, such as restrictions on executive compensation and on luxury expenditures.<sup>7</sup>

Some members of Congress noted that SBLF substantially resembled TARP and expressed doubt that lending would increase. SIGTARP also raised this concern for TARP banks applying to SBLF. In September 2010, SIGTARP sent a letter to Treasury Secretary Geithner recommending that Treasury not count TARP capital when evaluating the health and viability of a bank applying for SBLF, stating “it

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<sup>4</sup> The Jobs Act defined qualified small-business lending as loans of \$10 million or less or to businesses with \$50 million or less in revenues. Qualified loans were limited to 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.

<sup>5</sup> For further discussion on these SBLF investments into TARP banks, see SIGTARP’s report, “TARP & SBLF: Impact on Community Banks,” published April 25, 2012, [www.sig tarp.gov/Audit%20Reports/TARP\\_SBLF\\_Special\\_Section.pdf](http://www.sig tarp.gov/Audit%20Reports/TARP_SBLF_Special_Section.pdf).

<sup>6</sup> According to Treasury’s “SBLF: Getting Started Guide For Community Banks,” the cost of capital (the dividend rate) for SBLF started at no higher than 5%. If the bank increased its small-business lending by 10% or more, the rate would fall to as low as 1%. For increases in small-business lending of less than 10%, the rate could fall to between 2% and 4%.

<sup>7</sup> Treasury’s “SBLF: Getting Started Guide For Community Banks” stated, “Participation in the Small Business Lending Fund carries no executive compensation restrictions” and that any institution participating in SBLF would not be considered a TARP recipient.

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.” 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.”

In response to concerns that there were insufficient safeguards to ensure that banks would lend SBLF funds to small businesses, then-Chairwoman of the House Committee on Small Business, Nydia Velázquez, introduced language in a bill requiring banks to include a small-business lending plan with their SBLF application. In discussions on the House floor, Velázquez stated that she insisted on specific language in the Jobs Act to require “a detailed plan on how to increase small business lending at their institution.” According to Treasury, the small-business lending plan had to address:

- how the bank will use the funds to increase small-business lending in its community;
- the anticipated increases in small-business lending as a result of the receipt of funds; and
- proposed outreach and advertising efforts to inform members of the community about the availability of the loans and how to apply.

More than a majority of TARP community banks (320 out of 552) applied for SBLF funds.<sup>8</sup> Treasury conducted the same application review process for TARP banks as non-TARP banks, but added other conditions for TARP banks. Treasury required that banks that participated in SBLF could not continue to participate in TARP. TARP banks accepted into SBLF had to repay TARP in full, but could use SBLF funds to do so. Treasury required that banks be in material compliance with their TARP agreement, be current on TARP dividend payments, and not have missed more than one dividend payment.<sup>9</sup> Treasury would not consider the TARP banks’ ability to raise matching funds from private sources, which it allowed for non-TARP banks.

### The Government’s Process To Review Banks’ Applications for SBLF Funds

Congress required Treasury to consult with Federal banking regulators when making investment decisions. At the program’s launch, four Federal regulators – the Federal Reserve Board (“Federal Reserve”), FDIC, the Office of the

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<sup>8</sup> A total of 320 TARP banks applied to SBLF – 315 in CPP, and 5 of which were in the TARP Community Development Capital Initiative.

<sup>9</sup> Any dividend payment not submitted within 60 days of its due date was considered a missed dividend payment. Seventy-nine of the 320 TARP banks that applied for SBLF were not eligible to participate because they were not current on their TARP dividend payments.

Comptroller of the Currency (“OCC”), and the Office of Thrift Supervision – supervised the banks (and/or their bank holding companies) that applied to SBLF.<sup>10</sup> The Federal Reserve is the primary regulator for state member banks. In addition, the Federal Reserve regulates bank holding companies whose subsidiary banks are primarily regulated by the FDIC or OCC.

### SBLF Application Phase One – Federal Banking Regulator Review

The SBLF application review process included review by both Treasury and Federal banking regulators to determine each applicant’s suitability to receive SBLF funds.<sup>11</sup> Similar to applications for TARP, SBLF applications were routed to the banks’ regulators for review. Banks applying for SBLF were required to submit the small-business lending plan to their primary Federal regulator. However, according to the regulators interviewed by SIGTARP, the regulators primarily focused their review on the banks’ viability, as they did with TARP. For the purposes of SBLF, Treasury defined “viability” as the bank being (1) adequately capitalized, (2) not expected to become undercapitalized, and (3) not expected to be placed into conservatorship or receivership. Also similar to TARP, regulators were responsible for interpreting viability (under this definition) and providing a “yes” or “no” assessment, indicating that a bank was viable or not viable. In an interview, OCC’s Deputy Comptroller for Thrift Supervision told SIGTARP that the regulator’s review process to determine viability was “left over” from TARP.

Similar to TARP, if the banking regulator determined that the bank was “viable,” the regulator forwarded the application, including a viability assessment of the applicant bank, to Treasury. In addition to providing a viability assessment for each OCC-regulated SBLF applicant, OCC also made a recommendation to Treasury on whether to fund each applicant. According to Treasury, it treated a negative OCC funding recommendation equally to a negative viability assessment, rejecting the application if no additional considerations were identified. The Federal Reserve and FDIC did not make recommendations to Treasury beyond the viability determination.

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<sup>10</sup> During the application period, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 eliminated the Office of Thrift Supervision and transferred its rulemaking authority to the OCC and the Federal Reserve. Supervisory authority was transferred to OCC, the FDIC, and the Federal Reserve. The transfer of these powers was completed on July 21, 2011, and the Office of Thrift Supervision was officially abolished 90 days later, on October 19, 2011.

<sup>11</sup> State regulators were also given an opportunity to weigh in.

## SBLF Application Phase Two – Treasury Review

Treasury made investment decisions based in part on the regulators' determinations of viability. As with TARP, there was an interagency advisory committee that was comprised of at least one representative from each regulatory agency (FDIC, Federal Reserve, and OCC) to review certain applications.<sup>12</sup> If the banking regulator decided that a bank was viable, but the bank met certain criteria indicating risk, the interagency advisory committee reviewed the application. The criteria that would trigger this interagency review included weak or dated bank ratings (known as CAMELS ratings<sup>13</sup>), current financial performance ratios indicating soundness concerns, or examinations by the regulators indicating recent deterioration in the condition of the bank, or poor Community Reinvestment Act performance (which is aimed at racially defined neighborhoods, and residents of low and moderate income neighborhoods).<sup>14</sup> This committee reviewed applications of banks that regulators deemed not viable and would either withdraw the bank from consideration or invite regulators to reevaluate the bank.

Treasury's decision to fund was made by a majority vote of Treasury's Investment Committee, comprised of five senior-level Treasury officials, with the final decision by Treasury's Deputy Assistant Secretary for Small Business, Community Development, and Affordable Housing Policy.<sup>15</sup> Along with the regulator viability determination, Treasury's Investment Committee reviewed a Treasury-prepared analysis of the bank's financial condition that focused on the likelihood that the bank would repay SBLF funds.

## Objective

SIGTARP conducted this review to determine whether Treasury and regulators consistently evaluated applications submitted by TARP banks to refinance into SBLF.

SIGTARP conducted the audit from January 2012 through February 2013, in accordance with generally accepted government auditing standards as prescribed by the Comptroller General of the United States. For a discussion of the audit's scope and methodology, see Appendix A.

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<sup>12</sup> The interagency advisory committee was known as the Application Review Committee. For purposes of this report, SIGTARP will refer to the Application Review Committee as the interagency advisory committee.

<sup>13</sup> CAMELS is a rating system whereby regulators assign banks a score of 1-5, with 1 being strongest, based on their Capital, Asset quality, Management, Earnings, Liquidity, and Sensitivity to market risk.

<sup>14</sup> The interagency advisory committee also reviewed applications for banks in which Treasury received inconsistent input from state and Federal banking regulators or where Treasury staff recommended interagency review.

<sup>15</sup> The Investment Committee was comprised of: the SBLF Director, the Assistant Secretary for Financial Institutions, the Assistant Secretary for Financial Markets, the Assistant Secretary for Economic Policy, and the Assistant Secretary for Management. Three Investment Committee members or their delegates were required for a quorum.

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

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 pay off TARP, rather than to increase lending. Treasury determined that as a matter of policy, both TARP and non-TARP applicants to SBLF would have to project lending growth at least equal to the amount of SBLF funding 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 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.” 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.<sup>16</sup>

Twenty-four TARP banks that received \$501 million in SBLF funds have not increased their lending while in SBLF.<sup>17</sup> The remaining former TARP banks have increased lending by just \$1.13 for each \$1 in SBLF funds they received.<sup>18</sup> 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.

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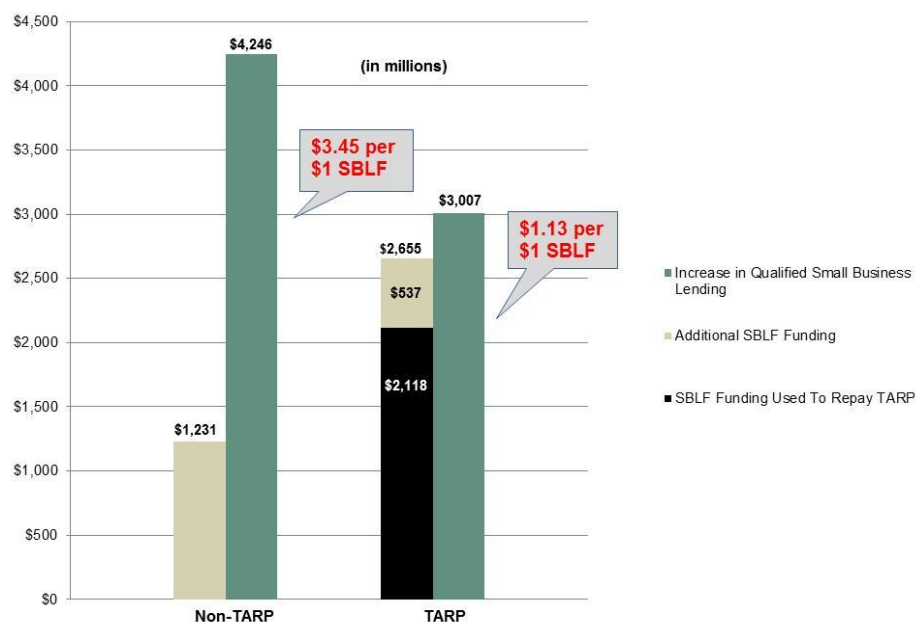
<sup>16</sup> Senator Maria Cantwell, a member of the Senate Committee on Small Business and Entrepreneurship, quoted an estimate by the Independent Community Bankers of America that the \$30 billion SBLF fund will generate up to \$300 billion in small-business lending. In June 2010, Congresswoman Melissa 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.

<sup>17</sup> 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.

<sup>18</sup> Qualified small-business lending per dollar of SBLF funding received is calculated by dividing the increase in qualified small-business lending by the amount of SBLF funding received.

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**



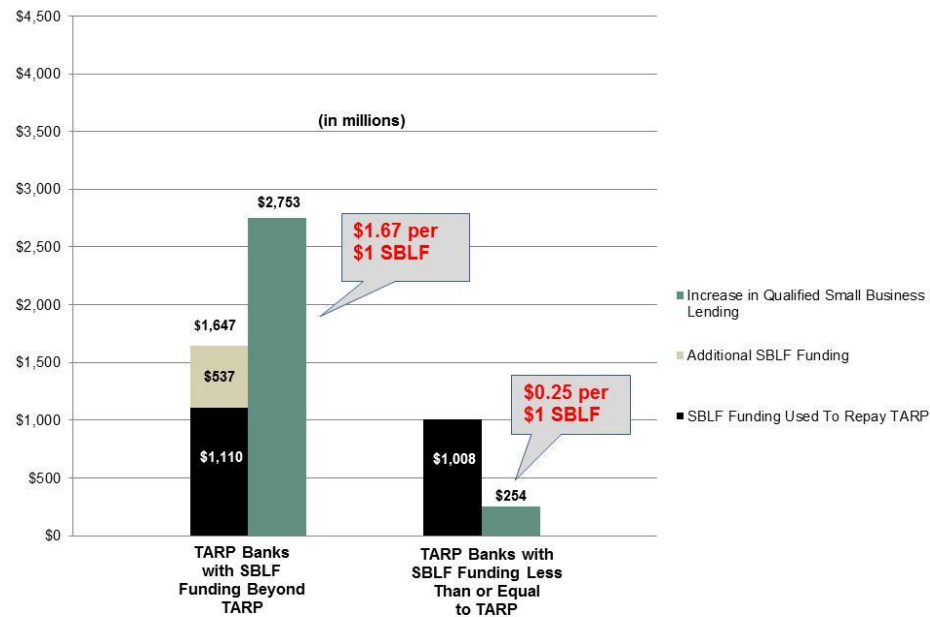
Note: Increases are calculated as the difference between Qualified Small Business Lending as of September 30, 2012, and the quarterly average of these loan balances for the four quarters preceding the legislation's passage (the same "baseline" period used by the program to calculate lending growth).

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. 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. TARP banks that received additional money beyond the outstanding TARP balance have increased lending by \$1.67 for every \$1 in SBLF funds.

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.

## Many TARP Banks Used SBLF Primarily as a Means To Exit TARP and Its Restrictions

Many TARP banks primarily looked at SBLF as an opportunity to exit TARP, escape TARP's restrictions, and pay less for taxpayer money. In a 2011 Government Accountability Office ("GAO") survey, some TARP banks cited the opportunity to exit TARP as the primary reason for applying for SBLF funds.<sup>19</sup> Banks that used SBLF funding to exit TARP were able to escape many of its

<sup>19</sup> GAO, "Small Business Lending Fund: Additional Actions Needed to Improve Transparency and Accountability," GAO-12-183, December 2011. GAO received valid survey responses from 510 banks (non-TARP and TARP banks), of which 18% (approximately 92 banks) stated that they had applied to SBLF. Approximately 17 banks, 18% of the approximately 92 respondents that applied to SBLF, cited the opportunity to refinance out of TARP as a primary reason for seeking SBLF capital.

restrictions, such as TARP's governance restrictions, executive compensation restrictions, and limitations on luxury expenditures as well as the negative stigma that existed under TARP. In an October 18, 2011, hearing before the Senate Committee on Small Business and Entrepreneurship, senators cited an October 6, 2011, *Wall Street Journal* article that quoted a senior bank officer as saying that SBLF "gets you out of tough restrictions under TARP. But for us, the real incentive was to get that small-business loan growth and bring our interest rate down to 1%." The newspaper also cited a senior official from a community bank trade organization as saying that SBLF helps get smaller banks out of TARP.<sup>20</sup>

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. If the bank had remained in TARP, it would pay a 5% dividend for each of five years, after which the rate would increase to 9%. If a TARP bank that refinanced into SBLF fails to increase its small-business lending, its dividend rate will increase by 2 percentage points from, 5% to 7%, after the bank's 9th quarter in SBLF and there would be a 2% "lending incentive fee" to 9% on the fifth anniversary of the TARP investment.<sup>21</sup> This may explain why 320 of the 552 community banks (58%) in TARP applied to SBLF, while only 9% (615) of the roughly 6,700 community banks that were not in TARP applied.

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.

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<sup>20</sup> Maltby, Emily, and Loten, Angus, "Tale of Two Loan Programs," *The Wall Street Journal*, 10/6/2011.

<sup>21</sup> This additional fee expires 4½ years after Treasury's SBLF investment, when the dividend rate resets to 9% for all SBLF participants, including those that did not participate in TARP.

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

Overall, Treasury and regulators did not conduct consistent, meaningful reviews of the plans submitted by applicants that were supposed to explain how the banks would increase small-business lending under SBLF. 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. Similarly, 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. As a result, Treasury and the Federal regulators did not reject any TARP bank for SBLF because of the bank's lending plan.<sup>22</sup>

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. Many TARP banks may not have had the wherewithal to increase qualified small-business lending because they used SBLF funds entirely to repay TARP obligations. Other TARP banks may not have received enough additional funds to achieve the increases in lending proposed in their lending plans. Treasury and regulators would have detected such concerns with proper scrutiny of applicants' lending plans and required the banks to demonstrate the 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 to be unsuited to participate in the program.

Furthermore, 14 former TARP banks have paid dividends to common shareholders while in SBLF, despite failing to increase their small-business lending. When Treasury provided banks with SBLF funds, it included restrictions on the distribution of dividends, should the banks' capital base fall below a certain level or should they miss payments to Treasury. However, no dividend

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<sup>22</sup> Fifty-nine of the 320 TARP applicants revised their plans for various reasons, of which 38 eventually received SBLF funding.

restrictions were placed on banks that failed to meet the projections established in their SBLF lending plans.

### Treasury and 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 document "Overview of the Application Review Process for the Small Business Lending Fund" states that Treasury would consult with banking regulators and perform "a detailed financial assessment, including an evaluation of the institution's likelihood of repayment, as well as a review of the applicant's small-business lending plan." This same Treasury document also states that the Federal banking agencies "received and reviewed the small-business lending plan submitted by each applicant." Treasury's SBLF program director told SIGTARP that Treasury did not perform an independent analysis of the projections in the lending plans. 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 Treasury's, not the regulators', responsibility.

Despite holding several meetings to discuss the SBLF application review process, Treasury and regulators failed to establish their respective roles and responsibilities for review and scrutiny of the banks' plans to increase small-business lending. FDIC Legal Counsel told SIGTARP that FDIC and Treasury met on numerous occasions to sort out their duties, and that Treasury should have been well aware of FDIC's interpretation of its responsibilities.

## 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. The Jobs Act specifically required that applicants, at the time they submit an application to the Secretary, shall deliver a small-business lending plan to their appropriate Federal banking regulator. The Jobs Act designated the lending plans as “confidential supervisory information,” a label that applies to information used by banking regulators in their supervision of banks. 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.

SIGTARP found that, during the application review process, regulators did not review banks' plans to increase lending in the same manner. The FDIC was the regulator for 69% of the TARP applicants for SBLF. According to an FDIC official interviewed by SIGTARP, the FDIC did not analyze the lending plans and served only as a conduit and broker to Treasury. FDIC guidelines instructed its staff that no input was necessary unless an institution's plan to increase small-business lending presented safety and soundness concerns. Rather, FDIC deferred the responsibility for analyzing the lending plans to Treasury, which lacked the regulators' familiarity with the applicants. 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.

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, but that OCC weighed in as well on the plans. The OCC official told SIGTARP that OCC examiners reviewed the lending plans for reasonableness. In addition, in SIGTARP's review of 32 applications, the OCC provided input to Treasury on the lending plans for all 5 applicant TARP banks regulated by the OCC.


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. The SBLF funding went to the bank holding company, not directly to the bank. A Federal Reserve official told SIGTARP that the Federal Reserve reviewed the lending plans, focusing on the impact of the plan on the safety and soundness of the bank, not on the adequacy and achievability of the proposed lending. When asked why the Federal Reserve often provided little or no input on lending plans to Treasury, the Manager of Community Banking Organizations at the Federal Reserve deferred responsibility to FDIC or OCC, which regulated the bank holding companies' 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. The Federal Reserve's Manager of Community Banking Organizations added that the Federal Reserve's examiners reported "by exception" on the lending plans, meaning that they would provide input to Treasury on the small-business lending plans only when they detected an issue. However, without meaningful review, it is unclear how the Federal Reserve would detect an issue. In addition, the Federal Reserve regulated 31 of the 32 bank applicants reviewed by SIGTARP. In SIGTARP's review, the Federal Reserve provided input to Treasury on the lending plans of only 7 of the 27 banks where the Federal Reserve regulated the bank holding company and all 4 applicant banks primarily regulated by the Federal Reserve.

### 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 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. Treasury did not consult with regulators or use their expertise in developing the form. Treasury assigned 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. 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.

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 _____	<b>MANDATORY LENDING PLAN ELEMENTS</b> Small Business Loan Growth (N/Y): _____ (Question 1.1) Business Lending History (N/Y): _____ (Question 1.2)	
Current Business Lending as % of Total Loans: _____%	PLAN SUFFICIENCY SCORE: <u>12</u> (Questions 1.1 – 3.4)	
Amount Requested: _____	CPP Refinance: <input type="checkbox"/> N <input type="checkbox"/> Y	
<b>1. Mandatory Lending Plan Elements</b>		
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 12/31/10 call report, greater than 10% of total loans? If not, does lending plan contain market entry plan?	<input type="checkbox"/> 0 <input type="checkbox"/> 1	
<b>2. Analysis of how SBLF participation will enable the bank to better address needs of small business</b>		
<b>2.1. Market Analysis:</b>		
2.1.1 Describes 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	
<b>2.2. Small Business Loan Production Experience:</b>		
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	
<b>2.3. Small Business Lending Infrastructure:</b>		
2.3.1 Describes bank's resources dedicated to small business.	<input type="checkbox"/> 0 <input type="checkbox"/> 1	
<b>2.4. Emphasis on Small Business Lending:</b>		
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	
<b>3. Analysis of how the bank would conduct outreach activities to increase small business lending</b>		
<b>3.1. General Media Outreach:</b>		
3.1.1 Describes use of general media outlets (print, radio, television, electronic).	<input type="checkbox"/> 0 <input type="checkbox"/> 1	
<b>3.2 Culturally Appropriate Media Outreach:</b>		
3.2.1 Institution targets 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	
<b>3.3 Community Outreach:</b>		
3.3.1 Describes membership and participation in community organizations and/or trade associations.	<input type="checkbox"/> 0 <input type="checkbox"/> 1	
<b>3.4 Linguistically Appropriate Outreach:</b>		
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 _____
Version 1.1 (5/31/2011)		SENSITIVE BUT NOT CLASSIFIED – DO NOT DISTRIBUTE

Source: Treasury.

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. Neither the interagency advisory committee nor SBLF program staff nor Treasury's Investment Committee addressed the lending plans for 91% of applications reviewed by SIGTARP. Almost all – 29 of the 32 TARP bank applications to SBLF that SIGTARP reviewed – showed no documented Treasury review of the banks' lending plans.<sup>23</sup> Minutes of the interagency advisory committee and Treasury's Investment Committee mentioned the lending plan for only 3 of the 32 TARP bank applications SIGTARP reviewed; only 1 of these applications received a response with a general statement that the lending plan "appeared to be responsive."

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:

- Two plans had lending projections lower than the SBLF funding requested, even though Treasury's policy required that lending be at least equal to SBLF funding.
- Three plans had lending projections based on a measure other than the required two-year timeline.
- Two plans that did not project a sufficient amount of lending were resubmitted with unsupported upward revisions to their lending projections.
- Two plans did not detail how the applicant would gain entry into the small-business lending market, although the applicants were required to do so.

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<sup>23</sup> Four of these applicants did not meet the criteria for review by the interagency advisory committee.

## Conclusion and Recommendations

Viewed by members of Congress as a fix for the Troubled Asset Relief Program's ("TARP") failure to require or incentivize banks to lend the money, the Small Business Lending Fund ("SBLF") provided participating banks with incentives to increase small-business lending. However, the scope and scale of SBLF were not as expected, with the U.S. Department of the Treasury ("Treasury") investing only \$4 billion of the available \$30 billion, two-thirds of which went to TARP banks that used SBLF to repay TARP in 2011. Although Congress allowed TARP banks to participate, Congress intended that the banks would increase their loans to small businesses, and as a safeguard, required that applicant banks submit to their Federal banking regulator a "small business lending plan" detailing how the bank would increase lending.

However, former TARP banks in SBLF have not effectively increased small-business lending and are significantly underperforming compared to non-TARP banks.<sup>24</sup> Twenty-four former TARP banks have not increased their lending while in SBLF, despite those banks collectively receiving \$501 million in SBLF funds. The remaining former TARP banks have increased lending by \$1.13 for each SBLF dollar they received. 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.

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. 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. TARP banks that received only enough SBLF funds to repay TARP have lent out significantly less than they received in SBLF funds – increasing lending by only 25¢ for each \$1 in SBLF funds. TARP banks that received additional SBLF money beyond the outstanding TARP balance have increased lending by \$1.67 for every \$1 in SBLF funds, a fraction of lending increases by non-TARP banks in SBLF.

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.

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<sup>24</sup> 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. Of the 137 institutions that exited TARP through SBLF, 132 remained in SBLF through the program's most recent reporting cycle ending September 30, 2012, the latest data available. Five of the original 137 institutions paid back Treasury subsequent to entering SBLF.

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.<sup>25</sup>

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. SIGTARP found that Treasury and the Federal banking regulators did not effectively communicate with each other, each claiming that the other had responsibility to assess the banks’ lending plans.

Treasury’s SBLF program director told the Office of the Special Inspector General for the Troubled Asset Relief Program (“SIGTARP”) that Treasury did not perform an independent analysis of the projections in the lending plans, and that analysis of the lending plans was the regulators’ responsibility because the law required that the lending plans be submitted to regulators. Regulators did not agree with Treasury’s view, and Office of the Comptroller of the Currency (“OCC”) and Federal Deposit Insurance Corporation (“FDIC”) officials told SIGTARP in interviews that they were conduits, passing the lending plans to Treasury. When SIGTARP asked the Federal Reserve Board’s (“Federal Reserve”) Manager of Community Banking Organizations whether the Federal Reserve had considered whether the lending goals in applicants’ plans were attainable, when some banks used all the SBLF capital to repay TARP, he responded that it was Treasury’s responsibility, not the responsibility of 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.

In reviewing bank applications for SBLF, Treasury and the banking regulators did not focus on whether the TARP banks were prepared to lend SBLF capital. Instead regulators generally focused on the banks’ viability, in a process described by one regulator as “left over” from TARP. 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. 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. Despite regulators

<sup>25</sup> If the bank had remained in TARP, it would pay a 5% dividend for each of five years, after which the rate would increase to 9%. If a TARP bank that refinanced into SBLF fails to increase its small-business lending, its dividend rate will increase by 2 percentage points from, 5% to 7%, after the bank’s 9th quarter in SBLF and there would be a 2% “lending incentive fee” to 9% on the fifth anniversary of the CPP investment.

giving some input to Treasury on some banks' lending plans, former TARP banks have not effectively increased small-business lending.

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 require applicants to provide specific details to support their ability to increase lending as proposed.<sup>26</sup> 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.

Treasury rejected a SIGTARP recommendation that Treasury should not count the TARP capital when evaluating the health and viability of TARP banks, despite SIGTARP's warning that it made little sense to convert a TARP bank to SBLF if the institution did not have the necessary capital to support increased lending. Treasury claimed that the action SIGTARP recommended could unfairly disadvantage the applicant bank. SIGTARP designed the recommendation to ensure that banks did not use SBLF to escape TARP, and its restrictions, without effectively increasing small-business lending, which unfortunately has come to fruition.

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

<sup>26</sup> 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. Treasury assigned 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.

TARP, Treasury should have found the banks unsuited to participate in the program and kept them in TARP.<sup>27</sup>

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 and 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. Similarly, the Government Accountability Office ("GAO") recently found that Treasury, regulators, and other members of the Financial Stability Oversight Council ("FSOC")<sup>28</sup> "could do more to promote collaboration" in carrying out FSOC's mission, specifically faulted FSOC for insufficiently leveraging resources and for not establishing roles, responsibilities, and joint

<sup>27</sup> Furthermore, 14 former TARP banks have paid dividends to common shareholders while in SBLF, despite failing to increase their small-business lending. When Treasury provided banks with SBLF funds, it included restrictions on the distribution of dividends, should the banks' capital base fall below a certain level or should they miss payments to Treasury. However, no dividend restrictions were placed on banks that failed to meet the projections established in their SBLF lending plans.

<sup>28</sup> Established under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, the Financial Stability Oversight Council is chaired by the Secretary of the Treasury and comprised of Federal financial regulators, state regulators, and an independent insurance expert.

strategies. Although the GAO report addresses a different joint initiative, its findings indicate that the lack of coordination and communication that SIGTARP identified in the SBLF application process is an ongoing issue that persists across other joint efforts between Treasury and regulators. Implementing appropriate corrective action could prevent Treasury and regulators from repeating past mistakes in future collaborative endeavors.

Accordingly, SIGTARP recommends that:

1. Treasury and the Federal banking regulators should improve coordination when collaborating on current and future initiatives by (1) defining the roles of all participants at the outset of collaborative efforts by creating precise and directed governing documents (*i.e.*, charters) that clearly address the responsibilities of each entity; and (2) jointly documenting processes and procedures, including flowcharts, risk management tools, and reporting systems to ensure that objectives are met. Each participant should sign off to demonstrate their understanding of, and agreement with, these procedures.
2. To increase small-business lending by former TARP banks participating in SBLF, Treasury should work with the banks to establish new, achievable plans to increase lending going forward.
3. 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.

## Management Comments and SIGTARP's Responses

### Treasury's Comments

Treasury stated statistics that as a group former TARP banks in SBLF have increased lending. SIGTARP recognizes an increase in lending by all but 24 of those banks, but finds it not effective (\$1.13 for each \$1 SBLF), particularly in comparison to non-TARP banks (\$3.45 for each \$1 SBLF). Congress did not set a benchmark or goal that as a group SBLF banks increase lending by 10%, as Treasury contends. Treasury's 2011 press release states that the SBLF funds would increase lending by "many multiples" of the SBLF amount, and there are similar statements by members of Congress. It was never the expectation that SBLF banks would only lend out the SBLF funds (a multiple of one). Moreover, 24 former TARP banks in SBLF have not increased lending, a fact that Treasury does not address. In addition, TARP banks that received only enough SBLF funds to repay TARP have lent out significantly less than they received in SBLF funds – increasing lending by only 25¢ for each \$1 in SBLF funds, another fact that Treasury does not address. SIGTARP's concern is not that TARP banks could exit TARP through SBLF (as Treasury contends), but instead that the TARP banks that did would have a meaningful impact on lending to small businesses, which unfortunately has not occurred, but still could occur with new lending plans.

Treasury disagreed that its communication with the regulators was not effective, claiming that SIGTARP's report has errors and omissions, without disputing the facts or data in the report. This statement appears to be merely a disagreement with SIGTARP's findings. The only factual dispute that Treasury claims is that SIGTARP "apparently relies on misquotes or out-of-context statements from SBLF's program director to argue there was a miscommunication." SIGTARP accurately quoted a statement made by Treasury's SBLF program director in an interview with SIGTARP that Treasury did not perform an independent analysis of the projections in the lending plans, and that the analysis was the regulators' responsibility, rather than Treasury. SIGTARP presents this statement in the exact context in which it was used – in a discussion of who was responsible for the lending plans. His statement was borne out by SIGTARP's document review. Importantly, Treasury is not saying now that it performed an independent analysis of the projections in the lending plans or that the analysis was its responsibility. Rather, Treasury says that it did a "serious review" and rejected as inadequate 30% of plans. Treasury rejected the plans for missing information and banks resubmitted the information. Treasury did not conduct a substantive analysis of the lending projections. The miscommunication also is based on document review and SIGTARP interviews with officials from the FDIC, the OCC, and the Federal Reserve, who told SIGTARP that they believed Treasury had

responsibility for analyzing the lending plans. Indeed, FDIC's official response to this report states, "It was agreed that Treasury, as program administrator and investor, would review the plans' sufficiency in relation to program goals and requirements." Clearly there was a miscommunication.

### **Federal Reserve's Comments**

The Federal Reserve disagreed that the regulators' review of lending plans was not meaningful. The Federal Reserve reviewed lending plans when it was the primary regulator but did not consistently review the plans when it regulated only the applicant bank's holding company. The SBLF money went to the holding company, and the Federal Reserve had another opportunity to analyze the plans to ensure that the bank could increase lending.

The Federal Reserve rejected SIGTARP's recommendation to preclude paying dividends by institutions that do not increase small-business lending, stating that it "does not believe that it is appropriate to use authority specifically designed to address the safety and soundness of depository institutions and their holding companies to direct firms to engage in particular types of lending." While historically, the banking regulators have focused only on safety and soundness, their role related to TARP, and here SBLF, has been unprecedented. For the first time, Treasury was investing in financial institutions and Treasury turned to those institutions' regulators for help in determining whether to make that investment. Because regulators took on this new role of consulting and providing recommendations that Treasury took into account in making its investment decision, it has a responsibility to protect taxpayers' investment. Taxpayers are not protected when banks that took SBLF funds to exit TARP did not increase lending, but still paid dividends to shareholders. If those banks do not have sufficient capital to lend as they promised the Government in taking the SBLF funds, they do not have sufficient capital to pay dividends. We acted as one Government in making the investment decision and must act as one Government in protecting that investment.

### **FDIC's Comments**

The FDIC confirmed that it was focused on safety and soundness, while it was Treasury's responsibility to review the lending plans. The FDIC agreed with SIGTARP's recommendation to improve coordination with Treasury, but rejected SIGTARP's recommendation to preclude dividend payments, claiming there is no authority in the Jobs Act. Banking regulators have significant authority to preclude dividends and if they need additional legislative authority, they should seek it.

### **OCC's Comments**

The OCC agreed that SIGTARP's data are "true," but states that there were other factors that influenced lending such as economic conditions. That is precisely why Treasury and banking regulators who knew these economic conditions should have analyzed the lending plans, and can still create new lending plans. The OCC agreed with SIGTARP's recommendation to improve coordination, but rejected the recommendation to preclude dividends, stating that national banks do not apply to pay dividends unless there are extraordinary circumstances, such as a provision in an enforcement action, and otherwise there is no basis in existing statutes to restrict dividends. The OCC can stop these dividend payments, and if the OCC believes it needs additional legislative authority, it should seek it.

## Appendix A – Scope and Methodology

We performed this audit under the authority of Public Law 110-343, as amended, which also incorporates the duties and responsibilities of inspectors general under the Inspector General Act of 1978, as amended. SIGTARP initiated this audit after institutions exited TARP by refinancing into SBLF, a program promulgated by the Small Business Jobs Act of 2010. Our objective was to determine the extent to which Treasury and regulators consistently evaluated applications submitted by TARP banks to exit TARP by refinancing into SBLF.

In November 2011, SIGTARP announced a review of Treasury’s SBLF application process because of the number of TARP institutions that exited TARP through SBLF and the significant amount of TARP investment that was refinanced into the new program. SIGTARP coordinated with other oversight agencies to ensure maximum coverage and to reduce any overlap, resulting in the report’s focus on the above objective.

To evaluate the SBLF application process established and implemented by Treasury and regulators between October 2010 and October 2011, we met with Treasury, OCC, FDIC, and Federal Reserve officials involved in the application process to discuss roles and responsibilities in the decision-making process. We also reviewed Treasury and regulator policies, procedures, internal controls, and documents relevant to the SBLF application and decision-making process for all SBLF applicants. We examined the processes by Treasury and regulators to assess the financial condition of all applicants and the lending plans they submitted. Additionally, we reviewed legislation pertaining to SBLF, including the Small Business Jobs Act of 2010, which provided Treasury with the authority to issue regulations and other guidance to permit eligible institutions to refinance from TARP to SBLF and the legislative history of the Act.

In addition to our work described above, SIGTARP selected a judgment sample of 32 applicants (or 10% of the total population of 320 TARP institutions that applied to the SBLF program). We drew only from the 164 institutions that proceeded far enough into the application process for Treasury to create an application package, including investment analyses. Among these, SIGTARP selected 32 of the marginal applications – those submitted by institutions deemed viable but where we identified one or more risk factors. These risk factors include, but are not limited to, low initial repayment probability, high levels of non-performing loans, low regulatory ratings, “stale” regulatory exams and ratings, and dividend restrictions that were either waived or lifted. Although a judgment sample does not permit projecting findings to the wider population, employing this methodology allowed SIGTARP to focus in more detail on the decision making applied to these applications.

To ensure our sample largely represented the population of TARP banks that applied to SBLF, SIGTARP considered each institution’s regulator, size, location, and whether or not it ultimately received SBLF funding. We then obtained additional information for each applicant, including regulator input, probability of repayment analyses produced by Treasury financial agents, small-business lending plans, and recommendations from the SBLF Application Review Team. The investment analyses SIGTARP reviewed outlined each bank’s financial standing and its ability to meet dividend requirements. We also reviewed the official meeting minutes of the SBLF

Application Review Committee (an interagency advisory committee) and the SBLF Investment Committee, bank examination reports, and Treasury and regulator emails.

We conducted our audit from January 2012 through February 2013. Our audit was conducted 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 findings and conclusions based on the audit objective. SIGTARP believes that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objective.

### Limitations on Data

SIGTARP generally relied on Treasury and regulators to provide relevant documentation, including email communications, examinations, and other files related to the SBLF application review process. To the extent that the documentation provided to SIGTARP by Treasury and regulators did not reflect a comprehensive response to SIGTARP's documentation requests, SIGTARP's review may have been limited.

### Use of Computer-Processed Data

To perform this audit, SIGTARP used data provided by Treasury. To assess the extent to which Treasury generated reliable data, we met with SBLF officials to discuss the database and data fields. Additionally, we tested the data using the SIGTARP matrix to identify any potentially significant reliability issues. We also relied on GAO's assessment and reliability conclusion on a similar SBLF dataset it reviewed and reported on in December 2011. Based on the results of our electronic testing, discussions with SBLF officials, and the determination made by GAO regarding a similar database provided by Treasury, we concluded that Treasury's data are sufficiently reliable for the purposes of our audit.

### Internal Controls

To assess internal controls pertaining to the SBLF application review process, SIGTARP interviewed staff and reviewed policies and procedures from Treasury, the FDIC, the Federal Reserve, and the OCC to determine the extent to which internal controls were reasonable and effective.

### Prior Coverage

SIGTARP has not performed any prior audits related to the SBLF program, although SIGTARP previously issued recommendations to Treasury regarding TARP banks refinancing into SBLF, which can be found in SIGTARP's Quarterly Report to Congress dated October 26, 2010. In addition, for further discussion on SBLF investments into TARP banks, see "TARP & SBLF: Impact on Community Banks," published April 25, 2012, in SIGTARP's Quarterly Report to Congress. [www.sig tarp.gov/Audit%20Reports/TARP\\_SBLF\\_Special\\_Section.pdf](http://www.sig tarp.gov/Audit%20Reports/TARP_SBLF_Special_Section.pdf)

## Appendix B – Acronyms and Abbreviations

CPP – Capital Purchase Program

FDIC – Federal Deposit Insurance Corporation

Federal Reserve – Federal Reserve Board

FSOC – Financial Stability Oversight Council

GAO – Government Accountability Office

Jobs Act – Small Business Jobs Act of 2010

OCC – Office of the Comptroller of the Currency

SBLF – Small Business Lending Fund

SIGTARP – Office of the Special Inspector General for the Troubled Asset Relief Program

TARP – Troubled Asset Relief Program

Treasury – U.S. Department of the Treasury

## Appendix C – Audit Team Members

This audit was conducted and the report was prepared under the direction of Bruce S. Gimbel, Acting Assistant Deputy Special Inspector General for Audit and Evaluation, Office of the Special Inspector General for the Troubled Asset Relief Program.

Staff members who conducted the audit and contributed to the report include Shawn Graham, Roxanne Caruso, Mary Jean, and Sean Morgan.

## Appendix D – Management Comments from Treasury, FDIC, OCC, and Federal Reserve



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.<sup>1</sup>

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:

<sup>1</sup> 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."<sup>2</sup> OIG also found that "institutions not admitted into the program received adequate consideration," and "applicants . . . received reconsideration based on consistent criteria."<sup>3</sup> Similarly, GAO found that "Treasury adopted procedures to help ensure that applicants were evaluated consistently and were likely to repay funds . . ."<sup>4</sup> 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.<sup>5</sup> 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 "[m]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.

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

<sup>3</sup> *Id.*

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

<sup>5</sup> 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

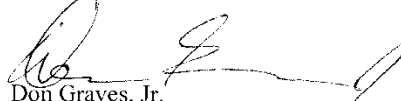
documented Treasury review of the banks' lending plans." However, each application file for those banks included a lending plan evaluation completed by Treasury staff.

#### **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



**Federal Deposit Insurance Corporation**  
550 17th Street NW, Washington, D.C. 20429-9990

Division of Risk Management Supervision

April 3, 2013

Ms. Christy Romero  
Special Inspector General for the Troubled Asset Relief Program  
1801 L Street, NW, 4<sup>th</sup> Floor  
Washington, D.C. 20220

Re: SIGTARP Draft Report, "Banks that Used the Small Business Lending Fund to Exit TARP"

Dear Ms. Romero:

The FDIC appreciates the opportunity to comment on your draft audit report concerning the Small Business Lending Fund (SBLF) Program. After reviewing the SIGTARP audit report in depth, the FDIC would like to address some of the report's findings and recommendations concerning the review of SBLF lending plans, supervisory restrictions on the payment of cash dividends, interagency coordination, and the SBLF Application Review Committee.

The respective roles and responsibilities of the FDIC and Department of the Treasury (Treasury) were memorialized in a memorandum of understanding (MOU) between the agencies.<sup>1</sup> As stated in the MOU, the Small Business Jobs Act of 2010 (the Act) required that Treasury consult with the FDIC regarding Treasury's evaluation of applications to the SBLF. It also set forth Treasury's responsibility to review and evaluate such applications and make investment decisions in accordance with the Act and other appropriate considerations, including FDIC's validation of viability. As part of this evaluation, Section 4103(d)(1)(E) of the Act required each SBLF applicant to provide a small business lending plan to its appropriate federal banking agency (AFBA) describing how its business strategy and operating goals would allow it to address the needs of small businesses in the areas it serves.

Treasury established a process that directed applicants to submit the prescribed SBLF lending plans to their AFBA, and Treasury discussed this process with the federal banking agencies. The Act did not provide for any approval or evaluation of the lending plans by either the federal banking agencies or the Treasury. It was agreed that Treasury, as program administrator and investor, would review the plans' sufficiency in relation to program goals and requirements. As indicated in your report, we received and reviewed the lending plans as part of our viability assessment consultation in accordance with the Act and the MOU to determine if any safety and soundness concerns were evident. The FDIC provided comments to Treasury in cases where our review of the bank's lending plan identified supervisory issues.

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<sup>1</sup> See Memorandum of Understanding between the U.S. Department of the Treasury and the Federal Deposit Insurance Corporation dated March 1 and March 9, 2011.

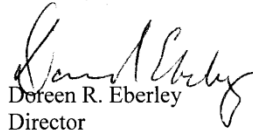
In addition, the draft audit report makes a recommendation that the federal banking agencies should disallow common stock dividends for SBLF participants that were formerly TARP participants if such institutions have not increased small business lending. With respect to this audit report recommendation, it should be noted that there is no authority in the Jobs Act providing such an "enforcement mechanism" to the federal banking agencies or to Treasury. Moreover, we believe that establishing a different standard for SBLF participants that were formerly TARP participants may be contrary to the Act.

We agree with your recommendation that Treasury and the federal banking agencies should strive for effective coordination when collaborating on initiatives. The FDIC entered into a bilateral agreement with Treasury for that express purpose.

The draft report also discusses Treasury's formation of an Application Review Committee to review certain SBLF applications. The report refers to this body as an "interagency advisory committee." In fact, the federal banking agency staff members that were detailed to this committee functioned as Treasury employees and were compensated by Treasury during the program. The FDIC detailee did not represent the FDIC while serving on this committee at Treasury.

FDIC staff would be happy to discuss these issues in further detail at a convenient time.

Sincerely,

  
Doreen R. Eberley  
Director



Office of the  
Comptroller of the Currency

## MEMORANDUM

To: Christy L. Romero, Special Inspector General for the Troubled Asset Relief Program

From: Thomas J. Curry, Comptroller of the Currency

Date: April 4, 2013

Subject: Comments on Draft Audit Report

We have received and reviewed your draft audit report titled "Banks that Used the Small Business Lending Fund To Exit TARP." The objective of your review was to determine whether Treasury and regulators consistently evaluated applications submitted by Troubled Asset Relief Program (TARP) banks to refinance into the Small Business Lending Fund (SBLF).

You are reporting that SBLF has not effectively increased lending by former TARP banks that used SBLF to exit TARP. While true, as evidenced by the data presented in your report, SIGTARP fails to acknowledge other factors that influence lending levels, such as economic conditions, loan demand, and the availability of creditworthy borrowers.

You are also reporting that Treasury and federal banking regulators did not adequately assess whether banks' plans to increase small-business lending were actually achievable. The Office of the Comptroller of the Currency (OCC) disagrees. The OCC provided input to Treasury on the lending plans for applicant TARP banks regulated by the OCC, as you could see from those that were in your sample for review. In addition, the OCC went beyond the required viability assessment to make a recommendation to Treasury on whether or not to fund the applicant.

Your report makes three recommendations.

We agree that it makes sense to define the roles of participants at the outset of collaboration and jointly document processes and procedures to ensure that objectives are met.

With regard to your second recommendation, OCC believes it is appropriate to add "in a manner that is consistent with safe and sound lending practices" after the word "plans" to read "... Treasury should work with the banks to establish new, achievable plans in a manner that is consistent with safe and sound lending practices to increase lending going forward."

While the recommendation to preserve capital in the institutions by restricting dividends to common shareholders is well-intended, it has no basis in existing statutes with respect to national banks. National banks do not apply to pay dividends unless there are extraordinary circumstances, such as a provision in an enforcement action. Otherwise, national banks need only comply with 12 U.S.C. 56 and 12 U.S.C. 60. With respect to federal savings associations

(FSAs), in many circumstances they are not required by statute or regulation to obtain OCC approval for dividends. Where OCC has approval authority or input with respect to FSA dividends, the decision criteria are based on safety and soundness.

We appreciate the opportunity to comment on the draft report.



**BOARD OF GOVERNORS**  
OF THE  
**FEDERAL RESERVE SYSTEM**  
WASHINGTON, D.C. 20551

DIVISION OF BANKING  
SUPERVISION AND  
REGULATION

April 4, 2013

Ms. Christy L. Romero  
Special Inspector General  
Office of the Troubled Asset Relief Program  
1801 L Street, NW, Room 4223  
Washington, D.C. 20220

Dear Ms. Romero:

Thank you for the opportunity to formally comment on the draft report issued for comment by the Office of Special Inspector General for the Troubled Asset Relief Program (SIGTARP), *Banks that Used the Small Business Lending Fund To Exit TARP* ("draft report"). In addition to commenting on the two recommendations in the draft report that are relevant to the Federal Reserve Board of Governors (the "Board" or "Federal Reserve"), we would like to reiterate some points and technical comments that Board staff previously shared with SIGTARP staff and that were not included in the report.

The draft report covers a period of time when bank lending was declining and many bankers reported a lack of demand for credit and a shortage of credit worthy applicants. This is evidenced in the aggregate reporting of loans in regulatory reports at commercial banks with assets of \$10 billion or less. For 14 consecutive quarters (from December 2008 to March 2012), loan balances steadily declined. Aggregate loan balances did not begin to increase until the modest increase beginning in the second quarter of 2012. Statistics on small business and farm loan balances published on the FDIC website, along with its quarterly banking profile, show a similar pattern. Discussing these broader trends and general bank lending conditions that were evident during the period under review would have provided some important context for readers of the report.

The level of review that federal banking regulators ("regulators") gave to banks' lending plans is discussed at some length in the draft report. As communicated to SIGTARP staff, the Board has provided examiner guidance to ensure that each lending plan includes: (1) how the institution intends to use funding from the SBLF to address the

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needs of small businesses in the community it serves; (2) the projected increase in qualified small business lending the institution expects to attain two years after the investment; and (3) the institution's plan to provide linguistically and culturally appropriate outreach. The guidance further encourages examiners to review the lending plan in light of the overall business plan and directs them to note any supervisory findings, including any that would present any safety and soundness concerns. The draft report recognizes that in each case where the Board served as primary regulator, the Board provided input to Treasury about the bank's lending plan. In cases where the Board supervised and regulated the bank holding company but not the underlying bank, the Board also provided comments to Treasury where our review of the bank's lending plan uncovered an issue that warranted comment. We disagree with the draft report's conclusion that our reviews of lending plans were not meaningful.<sup>1</sup>

As we have noted previously, the draft report's description of the composition of Treasury's Application Review Committee is not correct. The regulators, including the Federal Reserve, provided staff that were on detail to the Treasury. The detailees were part of the Application Review Committee, but they represented, answered to, and worked on the behalf of Treasury while they were in that role. It was not an interagency advisory committee.

With respect to the draft report's recommendation that "Treasury and the [f]ederal banking regulators should improve coordination when collaborating on current and future initiatives," we believe that it is important to note that the Treasury and banking agency staffs communicated and coordinated closely to establish implementation procedures for the program. As required by statute, the regulators developed interagency small business lending standards based on the existing safety and soundness guidelines. The Board issued guidance to examiners in Supervision and Regulation Letter 10-17 to supervise in accordance with these standards on December 22, 2010. Additionally, the regulators coordinated with Treasury staff to develop a template to provide a consistent framework for the regulators' analysis of the SBLF applications.

We believe the intent of the recommendation that regulators "should not approve dividend distributions to common shareholders of former TARP banks that have not effectively increased small-business lending while in SBLF," is to promote additional small business lending. However, as the Board has indicated previously to the SIGTARP, the Board does not believe that it is appropriate to use authority specifically designed to address the safety and soundness of depository institutions and their holding companies to direct firms to engage in particular types of lending. Of course the Board will and does use its enforcement authorities to ensure that Federal Reserve supervised institutions comply with applicable law. However, the SBLF program was designed to encourage, rather than require, certain behavior through specific incentives established under the Small Business Jobs Act of 2010 for participating institutions to increase their small business lending.

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<sup>1</sup> Draft report, page 12.

-3-

As we noted in previous communications, we are concerned about a potential negative outcome of supervisory action associated with the volume of small businesses loan approvals. Linking a bank's ability to pay dividends to loan approval volume, as suggested in the report, could inappropriately incentivize banks to approve questionable loans in order to be able to pay dividends. A related practical consideration is how to translate the general goal of "effectively increase[ing] small business lending while in SBLF" into an enforceable, consistently-applied standard.

We appreciate this opportunity to respond to the draft report.

Sincerely,

A handwritten signature in blue ink, appearing to read "Michael S. Gibson".

Michael S. Gibson  
Director

## SIGTARP Hotline

If you are aware of fraud, waste, abuse, mismanagement, or misrepresentations associated with the Troubled Asset Relief Program, please contact the SIGTARP Hotline.

*By Online Form:* [www.SIGTARP.gov](http://www.SIGTARP.gov)

*By Phone:* Call toll free: (877) SIG-2009

*By Fax:* (202) 622-4559

*By Mail:*

**Hotline: Office of the Special Inspector General  
for the Troubled Asset Relief Program**  
1801 L Street, NW, 3<sup>rd</sup> Floor  
Washington, D.C. 20220

## Press Inquiries

If you have any inquiries, please contact our Press Office:

Troy Gravitt  
Director of Communications  
[Troy.Gravitt@treasury.gov](mailto:Troy.Gravitt@treasury.gov)  
202-927-8940

## Legislative Affairs

For Congressional inquiries, please contact our Legislative Affairs Office:

Joseph Cwiklinski  
Director of Legislative Affairs  
[Joseph.Cwiklinski@treasury.gov](mailto:Joseph.Cwiklinski@treasury.gov)  
202-927-9159

## Obtaining Copies of Testimony and Reports

To obtain copies of testimony and reports, please log on to our website at [www.SIGTARP.gov](http://www.SIGTARP.gov).

