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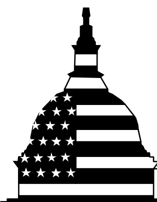
Report to Congressional Committees

December 2012

SMALL BUSINESS LENDING

Opportunities Exist to Improve Performance Reporting of Treasury's Programs



GAO-13-76

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Highlights

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

December 2012

SMALL BUSINESS LENDING

Opportunities Exist to Improve Performance Reporting of Treasury's Programs

Why GAO Did This Study

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

What GAO Recommends

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

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

What GAO Found

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

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

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

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Abbreviations

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

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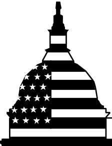

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Accountability * Integrity * Reliability

United States Government Accountability Office
Washington, DC 20548

December 5, 2012

Congressional Committees

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

To address these concerns, Congress passed the Small Business Jobs Act of 2010, which was signed by the President on September 27, 2010.[1] Among other things, this legislation aims to stimulate job growth by establishing the Small Business Lending Fund (SBLF) and the State Small Business Credit Initiative (SSBCI). The SBLF program is designed to encourage banks and community development loan funds (CDLF) with assets of less than $10 billion to increase their lending to small businesses with up to $50 million in annual revenues.[2] The act authorized the Secretary of the Treasury to make up to $30 billion of capital available and offered incentives to increase small business lending. However, interest in SBLF was lower than anticipated, with 935 financial institutions applying to the program for a combined funding request of $11.7 billion. By September 2011, the Department of the Treasury (Treasury) had ultimately approved $4.0 billion for 332 institutions through Treasury purchases of preferred stock or debt instruments—$3.9 billion to 281 banks and $104 million to 51 CDLFs. No additional SBLF funds will be awarded to banks or CDLFs.

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

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

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

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

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

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

[4]12 U.S.C. § 4107(c) and 12 U.S.C. § 5710 (b).

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

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

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

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

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

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

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

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

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

Background

Small Business Lending Fund

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

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

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

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

Fewer institutions applied to SBLF than initially anticipated, in part because many banks did not anticipate that demand for small business loans would increase. The institutions that applied to and were funded by SBLF were primarily institutions with total assets of less than $500 million. In addition, in our 2011 report, we reported that the lack of clarity by Treasury in explaining the program's requirements created confusion among applications and Treasury faced multiple delays in implementing the SBLF program and disbursing SBLF funds by the statutory deadline of September 27, 2011.[10]

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

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

[10]GAO-12-183.

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

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

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

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

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

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

State Small Business Credit Initiative

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

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

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

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

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

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

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

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

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

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

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

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

[14]GAO-12-183.

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

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

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

> (1) Any businesses receiving a loan from an SBLF participant using SBLF funds must certify to the institution that the principals of the business have not been convicted of a sex offense against a minor. Under the Securities Purchase Agreement, annually until redemption, the SBLF participant is required to provide the certifications to Treasury that businesses receiving loans from the bank have certified that their principals have not been convicted of a sex offense against a minor.
>
> (2) Each SBLF participant must certify that it is in compliance with the requirements of the Customer Identification Program, which is intended to enable the bank to form a reasonable belief that it knows the true identity of each customer.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

[20] 42 U.S.C. § 16911.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

As of June 30, 2012, SBLF participants had increased their business lending over the baseline from 2010.[22] For SSBCI, Treasury had transferred to the states nearly one-third of the program's $1.5 billion in total funding as of June 30, 2012. States had used about $154 million (about 10 percent) of these funds through a variety of programs. States had received and used funds at differing levels, but some states were concerned that Treasury may take actions to suspend disbursements after participants have been in the program for more than 2 years. Treasury has the authority to terminate disbursements to SSBCI participants who have not met the requirements to receive their full allocation within 2 years of having been accepted into the program. Treasury has not yet developed a policy that reflects how it will use this authority even though this 2-year period will end for most states sometime in 2013. Treasury officials stated that they do not plan to use this authority

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

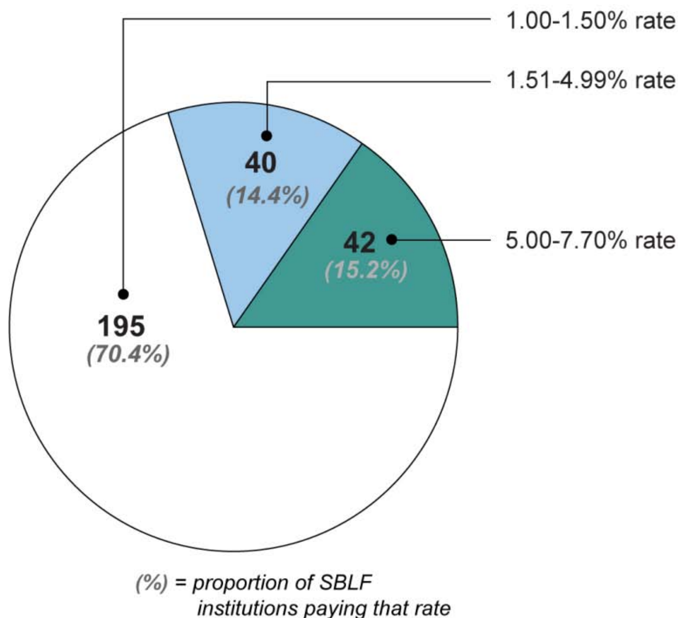
at this time and that Treasury will provide all participants with sufficient lead time so that they can modify or adjust their programs, as necessary.

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

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

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

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



Source: GAO analysis of Treasury data.

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

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

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

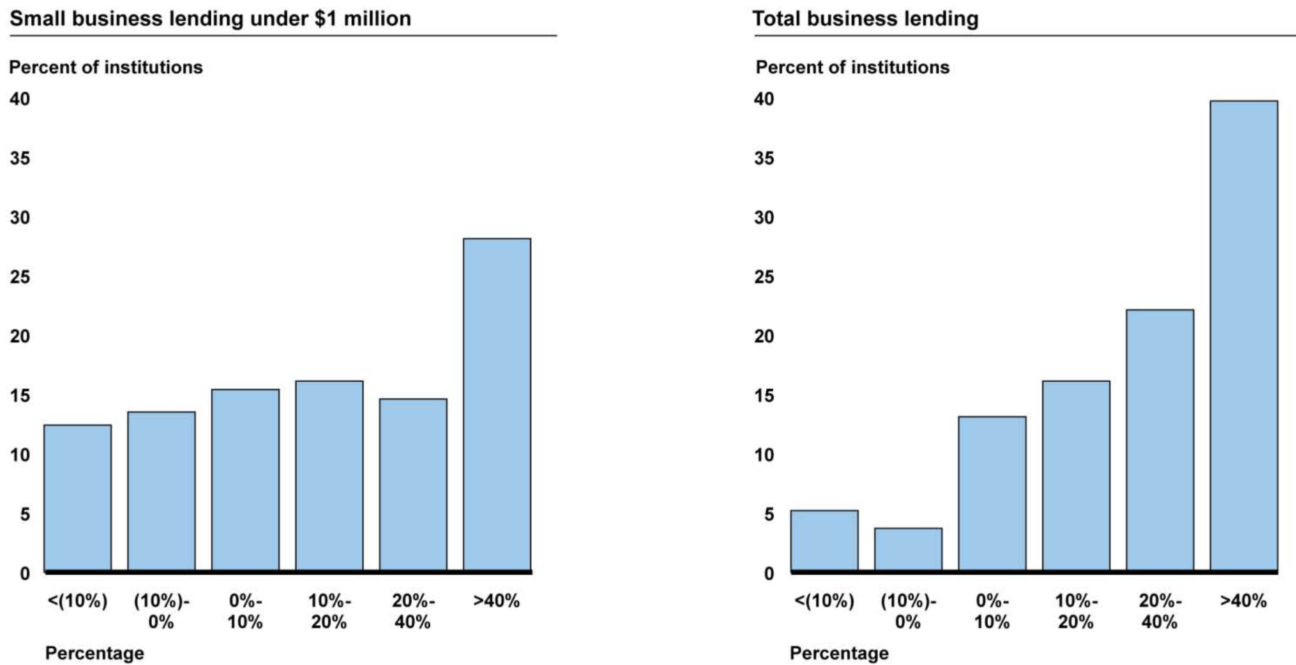
those to businesses with over $50 million in revenue—can also help illustrate differences in lending activity between these two groups.[26] Treasury uses total business lending in its reporting to compare SBLF participants to non-SBLF institutions and noted that qualified small business lending makes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

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

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

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

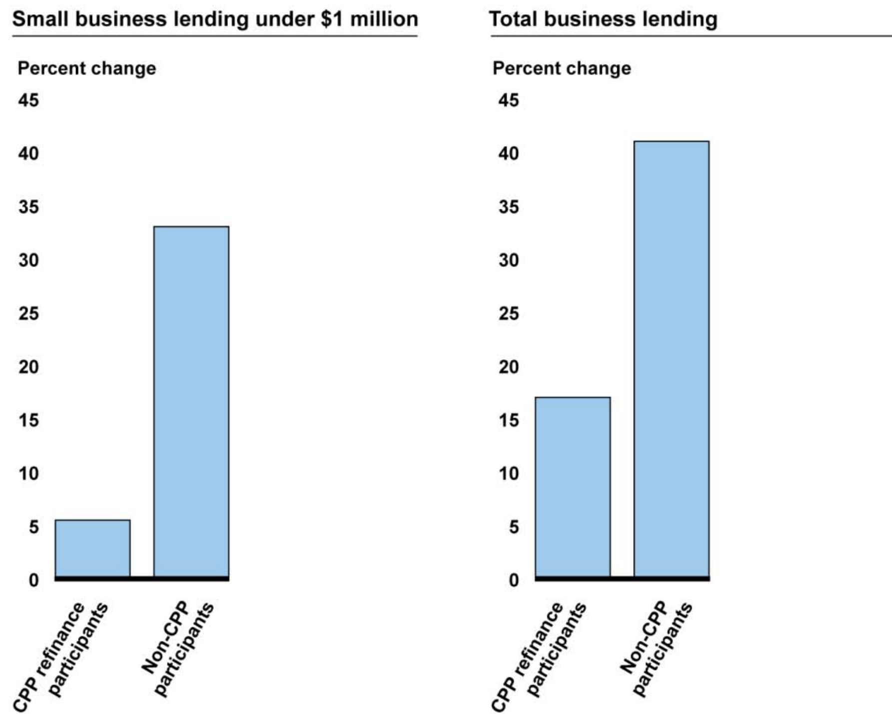
Figure 2: Distribution of SBLF Participants' Changes in Business Lending, from Baseline Level to the Quarter Ended June 30, 2012



Source: GAO analysis of SNL Financial data.

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

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

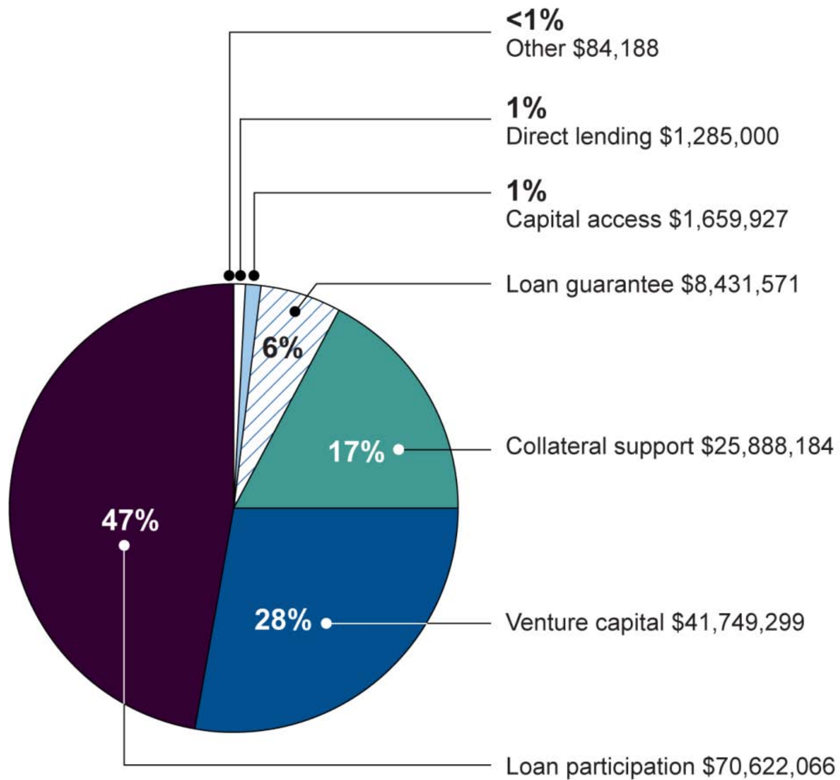


Source: GAO analysis of SNL Financial data.

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

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

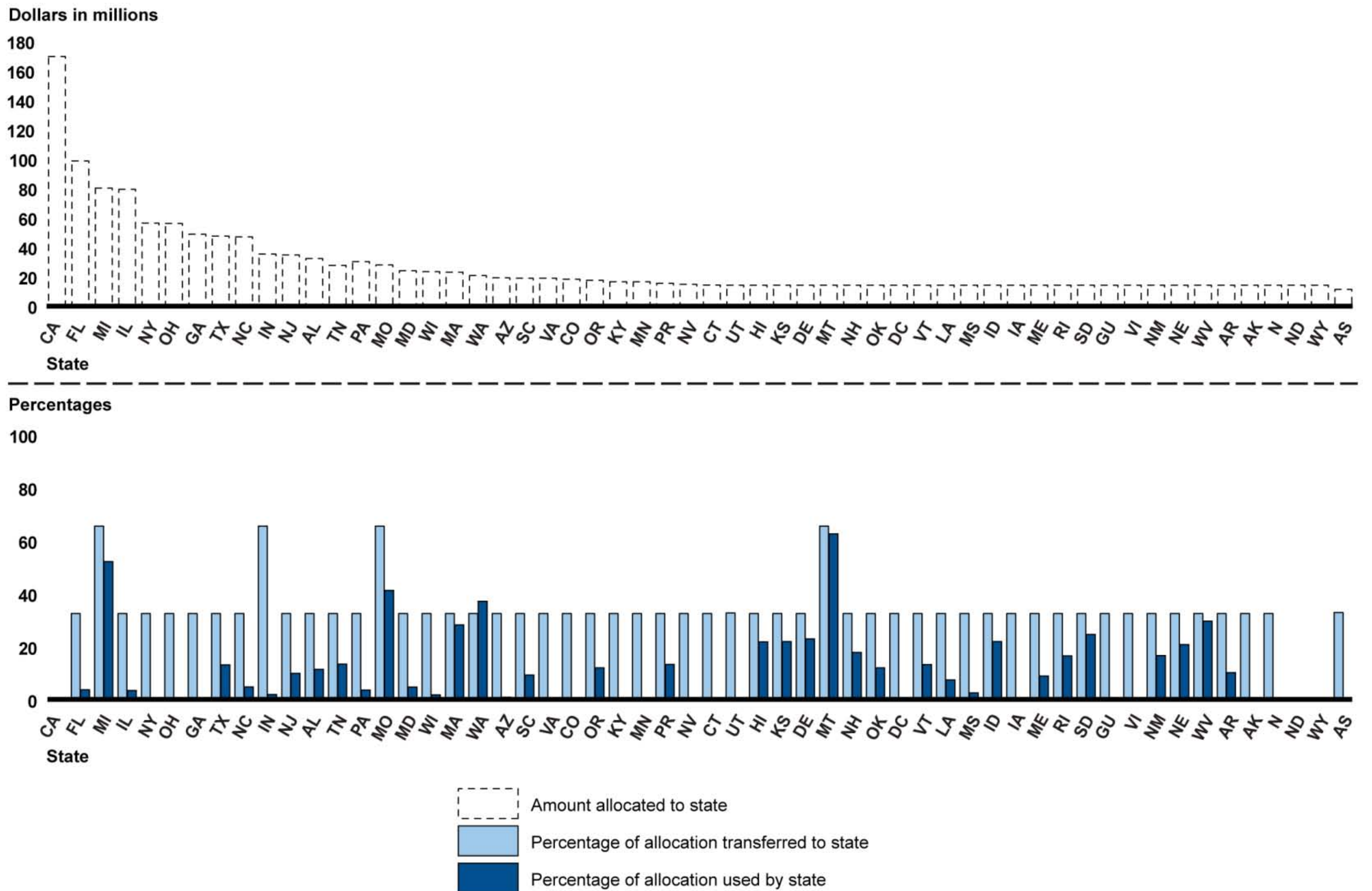
Figure 4: Cumulative SSBCI Funds Used by Program Type, as of June 30, 2012



Source: GAO analysis of Treasury data.

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

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



Source: GAO analysis of Treasury data.

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

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

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

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

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

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

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

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

Treasury Could Enhance Its Reporting of Program Performance Information

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

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

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

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

[29] GAO-12-183.

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

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

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

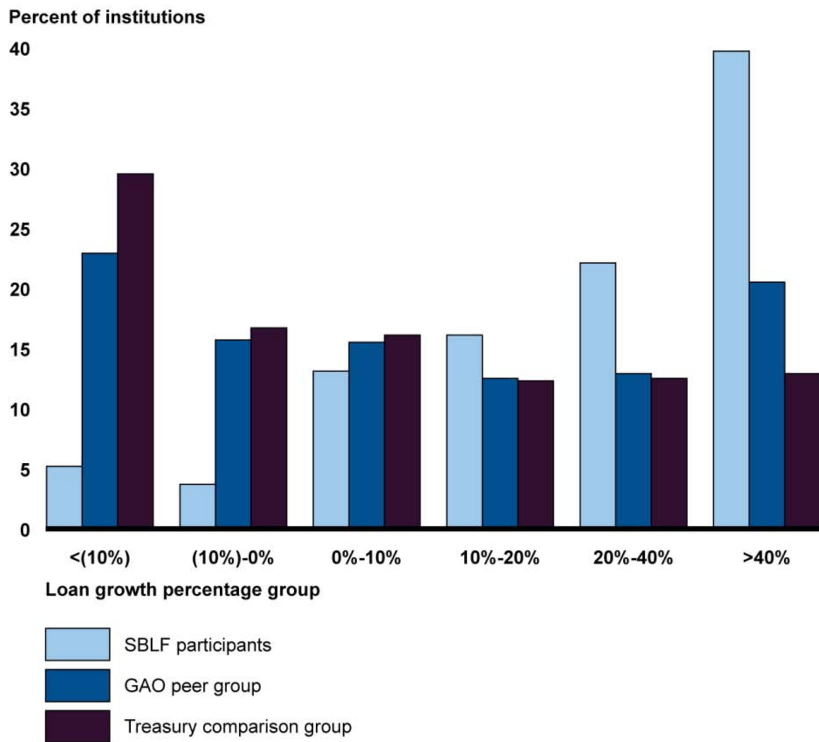
[31]We used the Texas Ratio as a proxy for financial health. It is defined as nonperforming assets plus loans 90 or more days past due divided by tangible equity and reserves. The Texas Ratio helps determine a bank's likelihood of failure by comparing its troubled loans to its capital. Because SBLF funding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

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

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

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

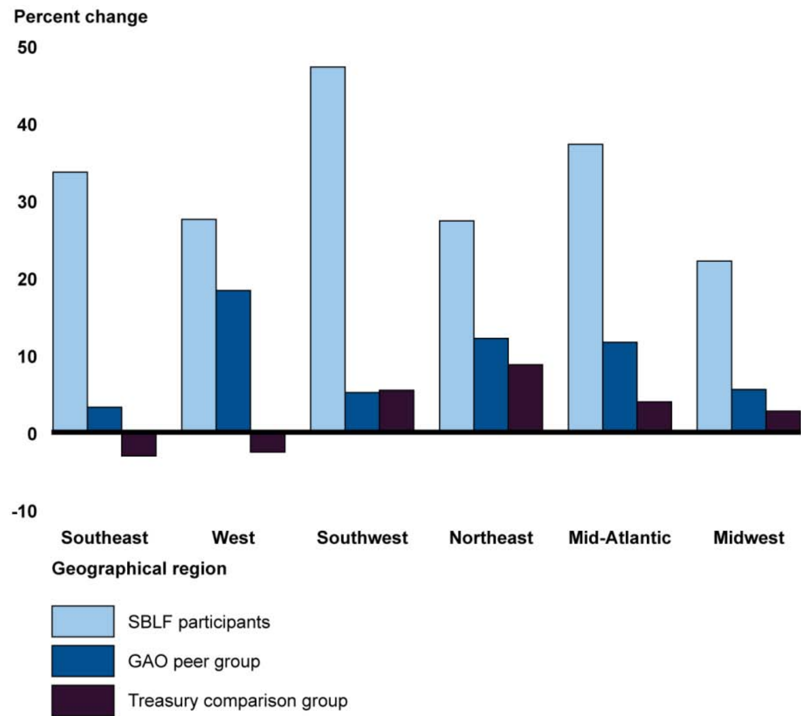
Figure 6: Distribution of Changes in Total Business Lending, from Baseline Level to the Quarter Ending June 30, 2012



Source: GAO analysis of SNL Financial data.

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

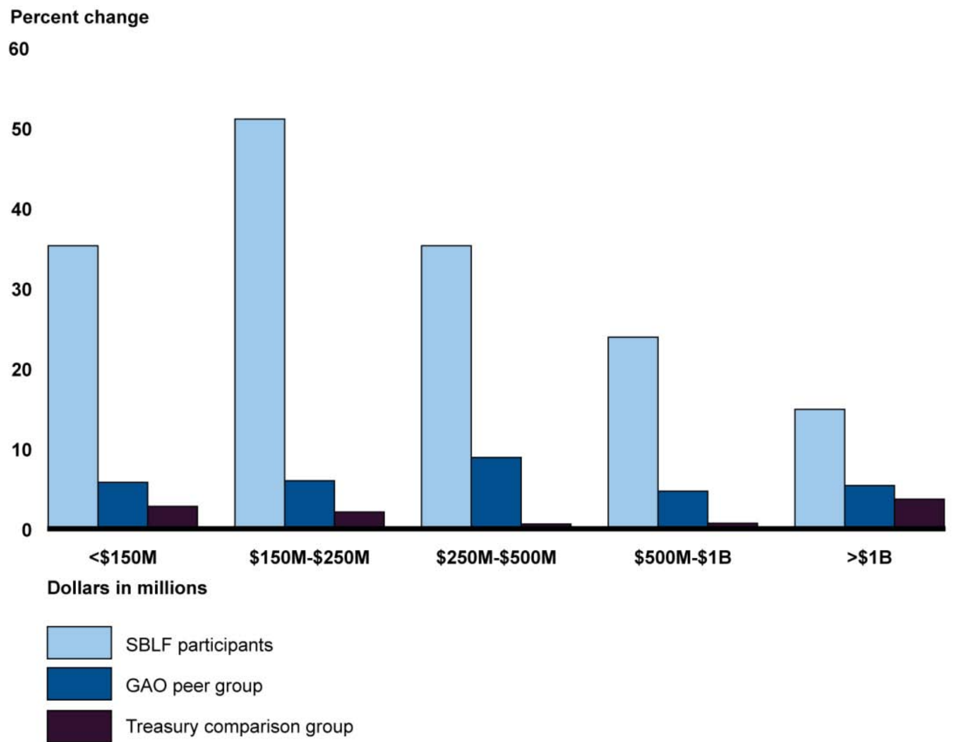
Figure 7: Median Changes in Total Business Lending by Geographical Region, from Baseline Level to the Quarter Ending June 30, 2012



Source: GAO analysis of SNL Financial data.

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

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



Source: GAO analysis of SNL Financial data.

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

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

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

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

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

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

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

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

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

Treasury Has Developed Performance Indicators for SSBCI

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

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

[37] GAO-12-173.

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

In addition, Treasury has developed measures for evaluating performance for SSBCI:

- amount of SSBCI funds used over time, as reported on SSBCI quarterly reports;
- volume and dollar amount of loans or investments supported by SSBCI funds, as reported on SSBCI annual report;
- amount, in dollars, of private-sector leverage in SSBCI annual reports; and
- estimated number of jobs created or retained in SSBCI annual reports.

Although Treasury has established measures for SSBCI performance, Treasury is considering how it will use these program performance indicators for evaluating the overall progress of SSBCI. Treasury staff recognized that performance indicators can help policymakers understand the results of the policy, but they emphasized that they do not have a full year of SSBCI data to use in evaluating the program. Many states did not receive their first SSBCI allocation until late 2011 and thus, Treasury had limited data to evaluate SSBCI. For example, Treasury told us that only 23 states reported using SSBCI funds to support small business loans or investments as of December 31, 2011. Treasury officials told us that after they have received the 2012 annual report data in early 2013, which would constitute a full year of SSBCI funds for almost all participants, they will be able to decide how they will review and analyze the performance measures going forward.

In addition, Treasury explained that SSBCI's performance cannot be evaluated using a single number or performance indicator because SSBCI consists of 140 different programs, and most states have multiple small business programs. For instance, Treasury has not created a specific number of estimated jobs as a target because so many factors can determine the use of funds—for example, the degree of interest by financial institutions and private investors, the performance of the state agency and any contractors that operate the approved program, and the

effectiveness of the program features designed by the state. How this program activity affects the level of employment in a state introduces many variables that can be difficult to predict. According to Treasury officials, specific numeric indicators, such as the number of loans resulting from state business programs, may or may not be indicative of the performance of SSBCI. In analyzing performance outcomes for SSBCI, Treasury staff advised us that outcomes are highly dependent on factors outside of the program's control, such as the demand for credit in a given locality and the quality of the small business borrowers' requests for such funds. Also, the states have different economies that may affect the results of the SSBCI funds. For example, Michigan's SSBCI funds are more concentrated in manufacturing, while other states may be more focused on providing assistance to small technological firms.

Information on SSBCI Performance Measures May Be Useful for Stakeholders

In contrast to SBLF, the act does not require Treasury or the states and municipalities to report to Congress or the public on the status of SSBCI. Rather, the act requires that SSBCI participants include certain data, such as the number and the dollar amounts of the loans resulting from SSBCI funds, in annual reports to Treasury. Treasury's performance measures will rely on the data from these annual reports. Treasury officials told us that they are considering making public some of the SSBCI performance data, but have not decided what specific SSBCI information will be released publicly or how it will be presented because they want to make sure the information reflects the outcomes in an appropriate context. As noted earlier, SSBCI covers a large number of programs across the country and other factors, such as local demand for credit, could lead to different performance outcomes across the participating states. Officials told us they plan to decide after they receive and review the 2012 annual reports. The GPRA Modernization Act (GPRAMA) requires agency performance information to be publicly available.[38] In reporting on the governmentwide implementation of GPRAMA in 2011, we noted that agencies need to consider the differing needs of various stakeholders, including Congress, to ensure that performance information will be both useful and used.[39] We reported that federal officials must understand how

[38]Pub. L. No. 111-352, 124 Stat. 3866 (2011).

[39]See, GAO, *Managing for Results: GPRA Modernization Act Implementation Provides Important Opportunities to Address Government Challenges*, GAO-11-617T (Washington, D.C.: May 10, 2011).

the performance information they gather can be used to provide insight into the factors that impede or contribute to program successes; to assess the effect of the program; or to help explain the relationships between program inputs, activities, outputs, and outcomes.

Information on SSBCI's performance measures regarding the amount of small business loans or investments and the amount of private leveraging resulting from SSBCI funds would provide Congress and SSBCI participants with useful information on the progress of SSBCI and its effectiveness in increasing small business lending. For example, two states told us that they would like more information on the performance measures of the other states' programs in order to better implement their own programs. Making the 2012 performance outcome data publicly available may assist the participating states in identifying successful small business state programs and the level of private leveraging that the states have achieved at this point in the SSBCI program. SSBCI applications were required to demonstrate a reasonable expectation that the programs would achieve a 10:1 ratio of new small business lending to SSBCI funds within specified timeframes. Information on the progress of SSBCI programs may help participating states to make necessary adjustments to their programs to more efficiently and effectively use their entire allocation of SSBCI funds.

Treasury Has Taken Actions to Enhance Communications with SBLF and SSBCI Program Participants

SBLF

Treasury has taken steps to address our December 2011 recommendation that it apply lessons learned from the SBLF application review process in order to improve how it communicates with program participants and other stakeholders, such as the bank regulators and Congress.[40] In response to the recommendation, Treasury officials told us that they have enhanced their communication strategy with SBLF participants and stakeholders and that they are better positioned to

[40] GAO-12-183.

respond to questions about SBLF. Shortly after the application review and approval period ended, Treasury assigned points of contact for each of the SBLF participants. Each point of contact was responsible for responding to inquiries from a designated group of participants and generally helping to ensure that the participants understood the compliance and reporting requirements. As the volume of inquiries has declined, Treasury shifted to a more centralized approach for handling inquiries. For example, all inquiries from SBLF participants are submitted to a centralized e-mail system, and they are then assigned to the staff responsible for (1) compliance, (2) investment management, and (3) operations. Compliance staff address questions about the Securities Purchase Agreements and the quarterly reports, and the reporting of qualified small business lending and the investment rates paid by SBLF participants. Investment management responds to inquiries relating to acquisitions and mergers and operations handle questions about redemption of SBLF shares and dividend payments. In addition, Treasury has assigned a staff member to handle external communications with Congress, the media, and the general public, including the reporting of qualified small business and the investment rates paid by SBLF participants. According to Treasury officials, they also communicate with industry and trade associations. Other communication methods established by Treasury included a webinar for instructing SBLF participants on completing the quarterly reports. Treasury staff told us that the purpose of the webinars was to reduce the number of errors in the quarterly reports.

In addition, on September 28, 2012, Treasury finalized written procedures to provide guidelines for answering inquiries to provide for consistency, continuity, and validity in communications with SBLF participants and their representatives. The guidelines describe the process by which a contact manager or staff member will communicate with SBLF participants. The process steps include the tracking and handling of incoming inquiries, outgoing mass communications, periodic reviews by business lines for potential Frequently Asked Questions, and the control manager’s reviews of control effectiveness. The procedures outline the communication roles and responsibilities of SBLF employees, the contact manager, and management.

SSBCI

SSBCI has also developed communication mechanisms to assist states in developing and implementing their state small business programs. Treasury has assigned three relationship managers whose role is to work with an assigned group of states in successfully allocating the funds to lenders and subsequently to borrowers. Moreover, Treasury has assigned

a consultant for three states that requested additional technical expertise in implementing their small business programs. Additionally, according to Treasury officials, Treasury has engaged a consultant to assist in educating lenders nationwide about the approved state programs and two consultants to assist with expertise in state-run venture capital to support SSBCI staff in providing technical assistance to state program managers

In addition to the relationship managers and consultants, Treasury has held two conferences for communicating with SSBCI participants. Under the act, Treasury is generally required to disseminate best practices to the states, and Treasury staff view the conferences as one method of doing so. The *SSBCI National Standards for Compliance and Oversight* are another example of disseminating best practices. According to Treasury staff, conferences provide state officials with the opportunity to discuss their programs with peers that are running similar programs and can potentially make modifications to their applications. During the March 2012 conference, states received information on the different types of small business programs, lenders, and Treasury assistance. The conference agenda showed that several panels were held. Generally, the panels consisted of state officials, who discussed their small business programs, such as the Loan Participation Program and the Venture Capital Program. In addition, four banks participated in the panels. Training sessions were held during the conference on the National Compliance Standards, on requests for modifications to the Allocation Agreements, and on subsequent disbursement requests of SSBCI funds. Officials from two states we interviewed told us that they found the March 2012 conference helpful. For example, one official stated that she found the conference assisted her in answering questions on compliance and on SSBCI small business programs. Treasury held a similar conference in early October 2012.

Conclusions

SBLF and SSBCI officials have made progress in developing procedures to monitor participants' compliance. In response to our previous recommendation on SBLF monitoring, Treasury has developed procedures for monitoring SBLF participant compliance with legal and reporting requirements. Treasury also issued the standards for compliance to provide states with best practices for reviewing participants' compliance with SSBCI's legal and policy requirements and developed procedures for sampling transaction-level data to evaluate the accuracy of the states' annual reports.

Most SSBCI participants have only received the first of three disbursements of their full allocation approved by Treasury, and some participants were concerned that they may have difficulty using the funds in time to meet the requirements to get their third and final allocation within 2 years. SSBCI participants lack a clear understanding of what actions Treasury plans to take if they do not meet the 2-year time frame. Although a Treasury official has publicly indicated that Treasury does not currently plan to exercise the authority to terminate funds that have not been allocated within 2 years from the states' approval date, it retains the authority to do so in the future. Treasury has yet to develop a formal written policy or guidance explaining its position. Clear and specific guidelines on how Treasury plans to use this authority to terminate funds will help ensure Treasury is consistent in how it applies this authority and may further encourage participants to develop programs and approaches to use the funds in a timely manner. Moreover, such a policy could also facilitate the ongoing communication between Treasury and the participants on how best to allocate and use the funds.

Treasury has taken some steps to evaluate the performance of SBLF and the extent to which SBLF participants are increasing their small business lending, but further refinements could provide a better assessment of the effectiveness of SBLF. As we found in our December 2011 SBLF report, Treasury has yet to finalize plans for assessing the performance of the program, including measures that can isolate the impact of SBLF from other factors that affect small business lending. As we found in Treasury's analysis as well as our own, SBLF participants appear to be increasing their small business lending since entering the program. However, as we recommended in our 2011 report, many factors can contribute to such increases, and Treasury should assess these trends taking other factors into account. While Treasury compared SBLF participants to non-SBLF institutions and reported this analysis in its Use of Funds Report, it did not provide important information on why it selected the comparison group that it used rather than using a peer group more closely matched to the SBLF participants. Our own analysis using a peer group showed that SBLF participants had increased their lending compared to peers, but also showed that the difference in small business lending growth was somewhat smaller than what Treasury's analysis suggests. The lack of explanation for Treasury's approach in the Use of Funds Report could create confusion about the rigorousness of the comparison. Furthermore, a more transparent description of the methodological decisions would help to enhance the transparency of the information reported. In addition, as we recommended in the 2011 report, Treasury should include in its plans for assessing the program a more robust evaluation that controls for

factors that affect small business lending, such as improved local economic growth. Without such an evaluation, policymakers, including Congress, may not have the information they need to assess whether the SBLF approach of using capital injections is a desirable policy option for increasing small business lending. Furthermore, a more transparent description of the methodological decisions would help to enhance the transparency of the information reported.

In addition, as we recommended last year, Treasury has created performance indicators to help monitor and measure the effectiveness of SSBCI. However, Treasury has not yet determined how and when it will make this information public. Treasury officials acknowledged the importance of this information for policymakers and have said they hope to develop a method for sharing this information publicly after they have had time to review the second annual reports that will be completed by the states next year. While we recognize that it is still early in the program and results vary greatly across the program participants for a variety of reasons, performance information is an important tool for policymakers, particularly as Congress reviews and considers programs to assist small businesses going forward. In addition, making this information public in a timely manner may help program participants, who could observe how their peers are performing and use this information to help them improve their own programs.

Recommendations for Executive Action

We recommend that the Secretary of the Treasury take the following three actions:

- To help ensure that Treasury is transparent and accountable in its decision making, Treasury should develop a written policy explaining how it will use the Secretary's discretionary authority to terminate the availability of allocated funds to SSBCI participating states if funds have not been transferred to the participant by the end of the 2-year period beginning on the date that the Secretary approved the state for participation.

- To enhance the transparency of its reporting on SBLF, Treasury should expand its methodology discussion in its Use of Funds Report to include the rationale for its methodology and alternative methodologies it considered.

- To provide Congress and the participating states with information on the progress of SSBCI, Treasury should make information publicly

available on its performance indicators measuring SSBCI's performance.

Agency Comments and Our Evaluation

We provided a draft of this report to Treasury for review and comment. The Deputy Assistant Secretary for Small Business, Community Development, and Affordable Housing Policy provided written comments, which are reprinted in appendix II. Treasury also provided technical comments on the draft report, which we incorporated as appropriate. In the written comments, Treasury agreed with the three recommendations and stated that it has begun to take steps to implement each of them. Specifically, Treasury said it has begun to develop a written policy for exercising its discretion to terminate any portion of a state's allocation not yet transferred to the state after two years. Treasury said it also will include the rationale for Treasury's methodology along with alternative methodologies that were considered in the methodology section of the next Use of Funds Report and that work is underway on publishing performance indicators that measure SSBCI outcomes. Treasury noted that the report reflected the progress SBLF and SSBCI had made in setting up compliance procedures and taking steps to improve communication with program participants. Treasury also stated that both programs are working as intended and that it expects both programs to continue to promote lending to small businesses.

We are sending copies of this report to the appropriate congressional committees and Treasury. The report also is available at no charge on the GAO website at http://www.gao.gov. If you or your staff members have any questions about this report, please contact Daniel Garcia-Diaz at (202) 512-8678 or garciadiazd@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix III.

Daniel Garcia-Diaz
Acting Director
Financial Markets and Community Investment

List of Committees

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

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

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

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

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

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

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

The Honorable Harold Rogers
Chairman
The Honorable Norman D. Dicks
Ranking Member
Committee on Appropriations
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The Honorable Paul Ryan
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Committee on the Budget
House of Representatives

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

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

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

Appendix I: Objectives, Scope, and Methodology

Our objectives were to examine: (1) the status of the U.S. Department of the Treasury's (Treasury) efforts to monitor participants' compliance with program requirements under the Small Business Lending Fund (SBLF) and the State Small Business Credit Initiative (SSBCI); (2) the status of SBLF and SSBCI participants' small business lending; and (3) the extent to which Treasury evaluates and communicates SBLF and SSBCI program outcomes.

To examine the status of Treasury's efforts to monitor participants' compliance with program requirements under SBLF and SSBCI, we analyzed Treasury's documentation. For SBLF, we reviewed and analyzed SBLF's *Participant Compliance Monitoring Procedures*, which were issued on September 28, 2012. We interviewed Treasury officials on their compliance program and the process by which staff review the Quarterly Supplemental Reports for their accuracy.

For SSBCI, we reviewed *SSBCI National Standards for Compliance and Oversight* and SSBCI Policy Guidelines. We reviewed the Allocation Agreements between Treasury and nine participating states that we interviewed to analyze the conditions and the requirements placed on the states. We interviewed Treasury officials on implementing the SSBCI compliance standards and officials from the states of Colorado, Florida, Georgia, Illinois, Massachusetts, Michigan, New Jersey, Oregon, and Texas. We judgmentally selected these nine states based on the following criteria: (1) the top 25 states awarded the most SSBCI funds; (2) geographical diversity; (3) states with at least two small business programs; (4) states that began using funds as of March 31, 2012, and states that had not yet used funds for any loans or investments as of March 31, 2012; and (5) avoiding states which have been reviewed previously by GAO or the Treasury's Office of the Inspector General. Because a large number of states had not spent their first allocation as of December 31, 2011, we used both the 2011 Annual Report and the Quarterly Report for March 31, 2012, to identify states' progress in allocating their funds. In terms of geographical diversity, we selected at

least two states from each of four regions: Midwest, Northeast, South, and West.[1]

To determine the status of SBLF, we reviewed the SBLF Use of Funds Reports to determine the most current level of qualified small business lending and the distribution of dividend or interest rates paid by program participants. Because Treasury requires only SBLF participants to submit data on qualified small business lending—generally, lending below $10 million— we also analyzed total business lending as well as small business loans under $1 million, which is available through the Call Reports.[2] We accessed the Call Report data using SNL Financial—a private financial database that contains publicly filed regulatory and financial reports—and analyzed lending by SBLF participants for the quarter ending June 30, 2012. The Small Business Jobs Act of 2010 (the act) establishes the baseline for measuring the change in small business lending as the average of the amounts that were reported for each of the four calendar quarters ended June 30, 2010. Call Reports did not begin requiring quarterly reporting of small business loans under $1 million until the second quarter of this four quarter baseline period. Accordingly, we calculated the baseline for small business loans under $1 million using the average of each of the three calendar quarters ended June 30, 2010. The act also defines one of the categories of qualified small business lending as owner-occupied nonfarm, nonresidential real estate loans. For quarterly reports of small business lending, Call Reports use a broader category of all nonfarm, nonresidential real estate without a distinction for owner occupancy. As a result, the small business loans under $1 million include the broader category. The total business lending numbers use the full baseline and the narrower categorization of owner-occupied nonfarm, nonresidential real estate and should therefore not be compared to the

[1]The Midwest region includes: Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota, and Wisconsin. The Northeast region includes: Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, and Pennsylvania. The South region includes: Alabama, Arkansas, Delaware, District of Columbia, Florida, Georgia, Kentucky, Louisiana, Maryland, Mississippi, North Carolina, Oklahoma, South Carolina, Tennessee, Texas, Virginia, and West Virginia. The West region includes: Arizona, California, Colorado, Idaho, Montana, Nevada, Utah, Oregon, Washington, and Wyoming.

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

numbers for small business loans under $1 million. We assessed the reliability of these data, for example, by analyzing missing data and performing various logic tests and determined that the data were sufficiently reliable for the purpose of reporting on SBLF lending.

To review SSBCI participants' small business lending, we collected and reviewed data from the Quarterly Report as of June 30, 2012—the most recent quarter available. We conducted data reliability checks on the SSBCI quarterly data for the dollar amounts transferred to the states and the dollar amounts used by each participating state to identify any potential discrepancies in the data. We interviewed Treasury officials on how they assessed these data. In addition, we verified with three states the data that they had sent to Treasury on the SSBCI Quarterly Report as of June 30, 2012. We also interviewed state and Treasury officials about the status of the use of SSBCI funds and Treasury's authority to suspend disbursements to SSBCI participants. Based on these steps, we determined that the data collected by Treasury for SSBCI were sufficiently reliable for the purpose of reporting total amounts of funds allocated and used by the states.

To examine the extent to which Treasury evaluates and communicates SBLF and SSBCI program outcomes, we reviewed Treasury documentation for both programs. For determining the extent to which Treasury evaluates the performance of SBLF, we reviewed the Use of Funds Report to evaluate the methodology Treasury used to assess the performance of SBLF participants against a comparison group of institutions that did not participate in SBLF. We interviewed Treasury officials to understand the process for developing the comparison group as well as the alternatives they considered. We used the methodology in the report to replicate Treasury's group for our analysis. To help understand the usefulness of the comparison group, we also chose a peer group of non-SBLF institutions that we adjusted for geographical and size distribution as well as financial health, using the Texas Ratio as a proxy.[3] To select the peer group, we started with our replication of Treasury's comparison group of 6,175 institutions and categorized them

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

into six asset-size groups. We then sorted the institutions by state, asset group, and Texas Ratio and generally assigned two peer institutions to each SBLF participant with the closest Texas Ratios, within the same state and asset group. In some cases, we had to make judgments in choosing the peers—for example, when two SBLF participants were similar to one another and when too few potential peers existed. We determined that any potential judgment factors were mitigated by the fact that the peer group mirrored the SBLF more closely than the comparison group across geographical and size distribution as well as financial health (see table 1). Consistent with the Use of Funds Report, we analyzed the growth in total business lending because qualified small business lending data were not available for non-SBLF institutions and because qualified small business lending totaled 95 percent of total business lending for the median SBLF participant as of December 31, 2011. Here we calculated the baseline using the average of the four quarters ending June 30, 2010. The data limitation mentioned earlier that required us to use only three quarters in the calculation of the baseline only applied to the availability of small business lending data, and the three-quarter baseline was used only in those earlier sections. We compared our peer group with Treasury's comparison group and compared both to SBLF participants. We also compared Treasury's analysis against our previous work on program evaluation as well as best practices identified by the Office of Management and Budget. In assessing the SBLF communication process, we reviewed and analyzed SBLF's Contact Management Procedures and interviewed Treasury officials on how they communicated with SBLF participants.

Table 1: Summary Data on SBLF Participants, GAO's Peer Group, and Treasury's Comparison Group

	SBLF participants	GAO peer group	Treasury comparison group
Number of institutions	267	503	6,175
Small business lending growth, under $1 million (median)	14.4%	N/A	N/A
Total business lending growth (median)	31.0%	6.1%	2.2%
Assets (median)	$356,082	$356,687	$155,354
Texas Ratio (median)	15.74	17.29	18.21
Southeast	23%	23%	19%
West	12%	11%	7%
Southwest	15%	15%	16%
Northeast	6%	6%	3%
Mid-Atlantic	15%	15%	7%
Midwest	29%	31%	48%

Source: GAO analysis of Treasury and SNL data.

For determining the extent to which Treasury evaluates SSBCI performance outcomes, we collected and reviewed the performance measures that Treasury developed for evaluating SSBCI. We interviewed Treasury officials on how they were planning to use the performance outcome measures in evaluating SSBCI. We also interviewed officials from the same nine states we described earlier—Colorado, Florida, Georgia, Illinois, Massachusetts, Michigan, New Jersey, Oregon, and Texas—to collect information on their evaluation and the performance information they reviewed relating to SSBCI. To analyze the communication of SSBCI performance outcomes, we reviewed the relevant provisions of the Small Business Jobs Act of 2010 and Treasury's outreach information that they had drafted for the states, such as conference materials.

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

Appendix II: Comments from the Department of the Treasury

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

November 28, 2012

Daniel Garcia-Diaz
Acting Director
Financial Markets and Community Investment
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Garcia-Diaz:

Thank you for the opportunity to review the draft report entitled *Small Business Lending: Opportunities Exist to Improve Performance Reporting of Treasury's Programs* (the Report). This letter provides the official response of the Department of the Treasury (Treasury).

The Report examines two Treasury programs established by the Small Business Jobs Act of 2010: the Small Business Lending Fund (SBLF) and the State Small Business Credit Initiative (SSBCI). We are pleased that the Report acknowledges that SBLF and SSBCI have made important progress in developing compliance processes, including SBLF's procedures for quarterly report monitoring and SSBCI's best practice guidance for compliance and oversight of funds. In addition, we appreciate the Report's finding that both programs have taken steps to enhance communication with program participants.

There is strong evidence that both SBLF and SSBCI are working as intended. As the Report notes, SBLF participants have achieved noticeably higher small business lending growth rates when compared to similar non-SBLF institutions. In addition, as of June 30, 2012, SBLF participants had increased their qualified small business lending by $6.7 billion over baseline levels and 76 percent of participants had increased small business lending by 10 percent or more. SSBCI is steadily gaining traction, with over 90 percent of participating states committing or disbursing funds by September 30, 2012. Treasury is confident that, as both programs move forward, they will continue to promote lending to small businesses so that these businesses can expand and create new jobs.

Treasury agrees with each of GAO's three recommendations. With respect to SBLF, the methodology section of Treasury's next *Use of Funds Report* will include the rationale for Treasury's methodology along with alternative methodologies that were considered. Regarding SSBCI, Treasury has already begun to develop a written policy for exercising its discretion to terminate any portion of a state's allocation not yet transferred to the state after two years. Work is also underway on publishing performance indicators that measure SSBCI outcomes.

Thank you once again for the opportunity to review the Report. Treasury values GAO's review of these programs and looks forward to continuing to work with your team.

Sincerely,

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

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Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

Daniel Garcia-Diaz, (202)-512-8678, garciadiazd@gao.gov

Staff Acknowledgments

In addition to the individual named above, Kay Kuhlman (Assistant Director), Pamela Davidson, Nancy Eibeck, Chris Forys, Michael Hoffman, Jonathan Kucskar, Marc Molino, Jennifer Schwartz, and Jena Sinkfield made key contributions to this report.

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