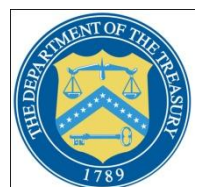




## Overview of the Application Review Process for the Small Business Lending Fund



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## Introduction

Small businesses are a vital part of the American economy. Their success is a necessary component of the economic recovery. Currently, many small businesses face challenges accessing the credit they need to grow and hire. Created in the Small Business Jobs Act of 2010 (the “Jobs Act”) to increase small business lending, the Small Business Lending Fund (“SBLF”) is designed to provide capital to qualified community banks and community development loan funds so Main Street financial institutions and small businesses can work together to help create jobs and promote economic growth in communities across the country.

This document describes the review process for community banks and thrifts that applied for SBLF funding. In total, 933 institutions applied for \$11.8 billion in SBLF funding.

Treasury engaged directly with community banks and community development loan funds to build nationwide awareness about opportunities to participate in SBLF. These activities included participating in nearly 40 industry events and teleconferences, hosting 15 webinars attended by more than 1,000 viewers, and completing more than 4,200 outbound calls to eligible institutions to provide information about the SBLF program. Treasury also established a dedicated website and call center that received more than 75,000 visits and 1,800 calls respectively.

Treasury issued preliminary approvals to 400 eligible institutions qualified for taxpayer investment. In total, these institutions were preliminarily approved for \$4.8 billion in SBLF funding. Of these, Treasury closed fundings with 332 institutions for more than \$4.0 billion. All closings were completed by September 27, 2011, the statutory end of the program.

## Application Review Process

To protect the taxpayer’s investment in this important program, Treasury worked closely with the federal banking agencies to develop and implement a thorough application review process. Treasury consults with each eligible applicant’s state and federal banking regulators and performs a detailed financial assessment, including an evaluation of the institution’s likelihood of repayment, as well as a review of the applicant’s small business lending plan.

Of the 933 applications received, more than 40 percent failed to meet minimum statutory or program requirements and therefore could not be approved. Of the applicants that did meet these minimum requirements, Treasury has approved all institutions qualified for taxpayer investment and well-positioned to extend credit to businesses in their communities.

Treasury evaluated all applications for SBLF funding received from banks and thrifts using a uniform, multi-stage review process, described as follows.

## Requirements for Consideration

1. **Verification of Preliminary Eligibility.** Treasury verified the preliminary eligibility of each applicant using publicly-available information to determine whether the applicant met the program eligibility requirements, confirming that:
  - The institution was in existence and had less than \$10 billion in total assets on December 31, 2009.
  - If the institution is a current or former participant in the Capital Purchase Program (CPP) or Community Development Capital Initiative (CDCI), it had not missed more than one dividend payment under such program (where a missed payment is defined as a payment not submitted or submitted more than 60 days after the due date).

2. **Verification of Supervisory Eligibility.** Treasury consulted with the Federal Deposit Insurance Corporation (FDIC) to determine whether the applicant was on problem bank list (defined as the list of institutions that have a current rating of 4 or 5 under the Uniform Financial Institutions Rating System), or had been on this list within the last 90 days.

In the case of institutions that are bank or thrift holding companies, Treasury verified that these applicants did not have any insured depository institution subsidiaries that were on the problem bank list, or that had been on this list within the last 90 days.

3. **Ability to Pay Dividends.** Treasury required each applicant to complete an Inquiry Regarding Dividend Payments form confirming that the institution was able to pay dividends on SBLF securities. The Jobs Act prescribes a specific dividend rate incentive structure for SBLF investments to encourage institutions to increase their small business lending. Institutions must be able to pay dividends on SBLF securities as a condition of participation in the program.

Treasury published a summary of terms for the SBLF program on December 20, 2010 that states that participating institutions are required to pay quarterly dividends on SBLF funding. In May, Treasury provided further information to applicants regarding this requirement so that institutions subject to restrictions on dividend payments would have additional time to seek their removal or waiver. Since these restrictions are imposed by an institution's prudential supervisors or applicable banking statutes or regulations, institutions subject to such restrictions needed to work directly with the appropriate governmental entities to obtain permission to pay dividends on SBLF funding.

4. **Receipt of Supervisory Consultations.** Treasury consulted with each applicant's appropriate federal banking agency and considered views received from the applicant's state banking regulator, if applicable.

The federal banking agencies provided Treasury with certain supervisory and financial metrics, a supervisory validation of viability for the applicant, and a written description of the applicant's condition. For the purpose of these consultations, the term "viability" is defined to mean that the applicant is (i) adequately capitalized, (ii) not expected to become undercapitalized, and (iii) not expected to be placed into conservatorship or receivership. The agencies' written description related to material supervisory issues with respect to the institution, including ongoing financial condition and enforcement actions, if any. In addition, the agencies received and reviewed the small business lending plan submitted by each applicant.

For applicants that are state-chartered, or had insured depository institution subsidiaries that are state-chartered, Treasury also requested and considered views received from the applicant's state regulator.

To receive SBLF funding, an applicant was required to receive a positive supervisory assessment from its appropriate federal banking agency. However, as described below, the Application Review Committee engaged in further consideration of any application that did not initially receive such an assessment from its regulator to confirm their determinations.

#### Application Consideration

5. **Review by the Application Review Committee.** The Application Review Committee was a deliberative body composed of senior banking supervisors from the FDIC, Federal Reserve Board, and Office of the Comptroller of the Currency that were detailed (i.e., assigned) to Treasury to serve in this role.

The purpose of the Application Review Committee was to ensure that the supervisory consultation process was applied effectively across SBLF investment decisions, and to provide recommendations to Treasury on certain SBLF applications as an additional control point and quality assurance mechanism. In general, applications were reviewed by the Application Review Committee if they met one or more of the following criteria:

- Institutions with a “3” composite CAMELS/RFI rating.
- Institutions with a composite CAMELS/RFI rating of “1” or “2” but which had one or more adverse performance ratios.
- Institutions with a composite CAMELS/RFI rating of “2” for which the most recent onsite examination was more than 12 months old or for which subsequent quarterly offsite exams indicated deterioration.
- Institutions that were identified by the appropriate FBA for consideration with matching private investment.
- Institutions for which Treasury’s investment analysis indicated a probability of loss above budgeted levels.
- Institutions that received an inconsistent supervisory input from the relevant state and federal banking regulators.
- Institutions that were otherwise recommended for review by Treasury staff.

The Application Review Committee also engaged in additional review of all applications that did not receive a positive supervisory assessment from the appropriate federal banking agency. Any additional considerations raised in the Application Review Committee’s review were shared with the relevant federal banking regulator, which then was invited to reevaluate the institution and provide an updated consultation to Treasury, if appropriate.

6. **Review by the SBLF Investment Committee.** The SBLF Investment Committee considered each application that fulfilled the minimum statutory or program requirements, and, if applicable, received a positive review from the Application Review Committee.

The Investment Committee is a five-member body, which includes the SBLF Director (Chairman) and the Assistant Secretary for Financial Institutions, the Assistant Secretary for Financial Markets, the Assistant Secretary for Economic Policy, and the Assistant Secretary for Management or their delegates. Recommendations of the SBLF Investment Committee are made by a majority vote of the present members.

Treasury staff prepared a comprehensive set of materials for each application for the Investment Committee's review. Materials compiled for each application included:

- The supervisory consultations submitted by the applicant's appropriate federal banking agency and state banking regulator, if applicable.
- An assessment of the probability of repayment for each investment, prepared by financial agents of the Treasury, including an evaluation of the applicant's capital structure, asset quality, capital adequacy, earnings capacity, and access to funding. This assessment considered, among other elements, the institution's expected forward ratio of Tier 1 common equity to risk-weighted assets at the end of the program's 4.5 year dividend rate incentive period.
- The institution's small business lending plan and an evaluation thereof completed by Treasury staff.
- An investment recommendation prepared by Treasury staff, including supporting data and analysis. This recommendation integrated the views of the financial agent with the supervisory consultation provided by federal and state banking agencies.

All approval recommendations made by the Investment Committee were considered for preliminary approval following the Investment Committee's decision, as described below. Applications that did not initially receive approval recommendations were reconsidered by the Investment Committee following the release of June 30, 2011 quarterly financial results.

#### Application Approval

- 7. Preliminary Approval.** Applications that were recommended for funding by the Investment Committee were presented for approval by the Deputy Assistant Secretary for Small Business, Community Development, and Housing Policy (the "Authorized Official").
- 8. Final Approval & Transaction Completion.** The Authorized Official provides final approval for all fundings. Prior to completing a funding, Treasury solicits and receives confirmation from the appropriate federal banking agency that there has been no material change in the institution's supervisory condition.

In addition, Treasury staff evaluates information regarding the applicant that has been made available subsequent to the SBLF Investment Committee's initial recommendation, including the institution's transaction disclosure schedules. The SBLF Investment Committee and/or the Authorized Official review this additional information as appropriate prior to completing the transaction.

#### Application of Matching Private Investment

For institutions that would not otherwise receive approval for SBLF funding, the Jobs Act permits Treasury and the appropriate federal banking agency to consider whether an applicant would qualify for SBLF funding if the applicant also raises matching private investment ("Private Investment").

Because weakness in an institution's regulatory capital position is frequently a consequence of unsatisfactory performance with respect to other supervisory elements such as management, asset quality, and earnings, the application of Private Investment was not appropriate in all cases. In making such assessments, Treasury and the appropriate federal banking agency may have considered, among other factors:

- The level, composition, and quality of regulatory capital.
- Overall asset quality and trends in asset quality, including the potential need to increase reserves and write down assets.
- Causes of historical losses in loans, securities, and other assets, and the likelihood that such underlying causes may be of a recurring nature.
- The level and quality of current and prospective earnings, including earnings capacity under plausible economic scenarios, and the likelihood that forward earnings will be sufficient to replenish levels of regulatory capital.
- The capability of key managers and the Board of Directors, responsibility of existing board of directors or management for decisions that have resulted in reductions in regulatory capital levels, and quality of risk management, internal controls, and underwriting practices.
- The institution’s ability to pay dividends and redeem outstanding securities as appropriate and in a timely manner without additional capital investment, including both SBLF securities and other outstanding securities.

#### **Example Scenarios Regarding the Application of Private Investment**

The following lists examples of situations in which the application of Private Investment could be found to be appropriate, among others:

- Institutions that have experienced significant losses in their securities portfolio, the source of which would not otherwise prompt concerns regarding investment or asset-liability management practices.
- Institutions that have experienced asset impairments assessed to be of a temporary nature, such as those arising from natural disasters or similar finite events, and for which the assets in question would reasonably be expected to recover in value.
- Institutions that have experienced historical losses that have depleted capital, but have since resolved these legacy asset quality challenges and returned to profitability, potentially following the investment of additional capital from private sources or introduction of new management.
- Institutions that may have sufficient capital to sustain their business operations, but would need additional capital to service dividends or redemptions of securities, whether mandatory or optional, with respect to either securities issued under SBLF or other outstanding securities.

#### **For More Information**

To learn more about the Small Business Lending Fund, please visit [www.treasury.gov/SBLF](http://www.treasury.gov/SBLF). For communications pertaining to a specific institution, please email [SBLFInstitutions@treasury.gov](mailto:SBLFInstitutions@treasury.gov).

For media inquiries, please call the U.S. Department of the Treasury Press Office at (202) 622-2960.