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The Small Business Lending Fund

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Summary

Congressional interest in small business access to capital has increased in recent years because of concerns that small businesses might be prevented from accessing sufficient capital to enable them to assist in the economic recovery. Some, including President Obama, have argued that the federal government should provide additional resources to assist small businesses in acquiring capital necessary to start, continue, or expand operations and create jobs. Others worry about the long-term adverse economic effects of spending programs that increase the federal deficit. They advocate business tax reduction, reform of financial credit market regulation, and federal fiscal restraint as the best means to assist small businesses and create jobs.

Several laws were enacted during the 111th Congress to enhance small business access to capital. For example,

- P.L. 111-5, the American Recovery and Reinvestment Act of 2009 (ARRA), provided the Small Business Administration (SBA) an additional $730 million, including funding to temporarily subsidize SBA fees and increase the 7(a) loan guaranty program's maximum loan guaranty percentage to 90%.
- P.L. 111-240, the Small Business Jobs Act of 2010, authorized the Secretary of the Treasury to establish a $30 billion Small Business Lending Fund (SBLF), in which $4.0 billion was issued, to encourage community banks with less than $10 billion in assets to increase their lending to small businesses. It also authorized a $1.5 billion State Small Business Credit Initiative to provide funding to participating states with small business capital access programs, numerous changes to the SBA's loan guaranty and contracting programs, funding to continue the SBA's fee subsidies and the 7(a) program's 90% maximum loan guaranty percentage through December 31, 2010, and about $12 billion in tax relief for small businesses.
- P.L. 111-322, the Continuing Appropriations and Surface Transportation Extensions Act, 2011, authorized the SBA to continue its fee subsidies and the 7(a) program's 90% maximum loan guaranty percentage through March 4, 2011, or until available funding was exhausted, which occurred on January 3, 2011.

This report focuses on the SBLF. It opens with a discussion of the supply and demand for small business loans. The SBLF's advocates claimed the SBLF was needed to enhance the supply of small business loans. The report then examines other arguments presented both for and against the program. Advocates argued that the SBLF would increase lending to small businesses and, in turn, create jobs. Opponents contended that the SBLF could lose money, lacked sufficient oversight provisions, did not require lenders to increase their lending to small businesses, could serve as a vehicle for Troubled Asset Relief Program (TARP) recipients to effectively refinance their TARP loans on more favorable terms with little or no resulting benefit for small businesses, and could encourage a failing lender to make even riskier loans to avoid higher dividend payments.

The report concludes with an examination of the program's implementation and a discussion of bills introduced during the 112th and 113th Congresses to amend the SBLF. For example, during the 112th Congress, S. 681, the Greater Accountability in the Lending Fund Act of 2011, would have limited the program's authority to 15 years from enactment and prohibited TARP recipients from participating in the program. H.R. 2807, the Small Business Leg-Up Act of 2011, would

have transferred any unobligated and repaid funds from the SBLF to the Community Development Financial Institutions Fund "to increase the availability of credit for small businesses." H.R. 3147, the Small Business Lending Extension Act, would have extended the Treasury Department's investment authority from one year to two years. During the 113th Congress, H.R. 2474, the Community Lending and Small Business Jobs Act of 2013, would transfer any unobligated and repaid funds from the SBLF to the Community Development Financial Institutions Fund.

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Small Business Access to Capital

Congressional interest in small business access to capital has increased in recent years because of concerns that small businesses might be prevented from accessing sufficient capital to enable them to assist in the economic recovery.[1] Small businesses, defined as having fewer than 500 employees, have played an important role in net job growth during previous economic recoveries, particularly in the construction, housing, and retail sectors.[2] For example, after the eight-month recession that began in July 1990 and ended in March 1991, small businesses increased their net employment in the first year after the recession, whereas larger businesses continued to experience declines in employment.[3] During the most recent recession (December 2007-June 2009), small businesses accounted for almost 60% of net job losses.[4] From the end of the recession through the end of FY2012, small businesses accounted for about 63% of net new jobs, close to their historical average share of net new job creation.[5] Since then, small businesses have added about 48% of net new jobs.[6]

Some, including President Obama, have argued that the federal government should provide additional resources to assist small businesses in acquiring capital necessary to start, continue, or expand operations and create jobs. Others worry about the long-term adverse economic effects of spending programs that increase the federal deficit. They advocate business tax reduction, reform of financial credit market regulation, and federal fiscal restraint as the best means to assist small businesses and create jobs.

[1] The United States does not have a statutory definition for medium-sized or large businesses. A business concern can either be considered *small* or *not small* under §3(a)(1) of the Small Business Act, 15 U.S.C. §632(a)(1), which indicates that a small business concern "shall be deemed to be one that is independently owned and operated and which is not dominant in its field of operation." The Small Business Administration (SBA) has established two widely used size standards: 500 employees for most manufacturing and mining industries and $7.0 million in average annual receipts for most nonmanufacturing industries. However, many exceptions exist. For example, a small business concern can have up to 1,500 employees for certain industry categories. The SBA's size standards may be found at 13 C.F.R. §121.201. For additional information and analysis, see CRS Report R40860, *Small Business Size Standards: A Historical Analysis of Contemporary Issues*, by Robert Jay Dilger. In contrast, the European Union defines small business as those with fewer than 50 employees, medium-sized business as those employing 50 workers to 250 workers, and large businesses as those with more than 250 employees. See European Commission, "Small and Medium Sized Enterprises: What is an SME?" at http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/sme-definition/index_en.htm.

[2] Brian Headd, "Small Businesses Most Likely to Lead Economic Recovery," *The Small Business Advocate*, vol. 28, no. 6 (July 2009), pp. 1, 2.

[3] U.S. Small Business Administration (SBA), Office of Advocacy, "Small Business Economic Indicators for 2003: A reference guide to the latest data on small business activity, including state and industry data," August 2004, p. 3, at http://archive.sba.gov/advo/stats/sbei03.pdf.

[4] SBA, "The Small Business Economy, 2010: A Report to the President," pp. 2, 5, 21, 22, at http://www.sba.gov/sites/default/files/sb_econ2010.pdf; and SBA, *Fiscal Year 2010 Congressional Budget Justification*, p. 1, at http://www.sba.gov/sites/default/files/Congressional_Budget_Justification_2010.pdf.

[5] SBA, Office of Advocacy, "Small Business Employment: Fourth Quarter 2013," *Quarterly Employment Bulletin*, February 6, 2014, p. 1, at http://www.sba.gov/sites/default/files/Quarterly_Employment_Bulletin_4q2013%20.pdf.

[6] SBA, Office of Advocacy, "Small Business Employment: Second Quarter 2014," *Quarterly Employment Bulletin*, September 9, 2014, p. 2, at http://www.sba.gov/sites/default/files/advocacy/sb_qi_2014q2_FIN_0.pdf.

Several laws were enacted during the 111th Congress to enhance small business access to capital. For example,

- P.L. 111-5, the American Recovery and Reinvestment Act of 2009 (ARRA), provided the Small Business Administration (SBA) an additional $730 million, including $375 million to temporarily subsidize SBA fees and increase the 7(a) loan guaranty program's maximum loan guaranty percentage from 85% on loans of $150,000 or less and 75% on loans exceeding $150,000 to 90% for all regular 7(a) loans.
- P.L. 111-240, the Small Business Jobs Act of 2010, authorized the Secretary of the Treasury to establish a $30 billion Small Business Lending Fund (SBLF) ($4.0 billion was issued) to encourage community banks with less than $10 billion in assets to increase their lending to small businesses. It also authorized a $1.5 billion State Small Business Credit Initiative to provide funding to participating states with small business capital access programs, numerous changes to the SBA's loan guaranty and contracting programs, funding to continue the SBA's fee subsidies and the 7(a) program's 90% maximum loan guaranty percentage through December 31, 2010, and about $12 billion in tax relief for small businesses.
- P.L. 111-322, the Continuing Appropriations and Surface Transportation Extensions Act, 2011, authorized the SBA to continue its fee subsidies and the 7(a) program's 90% maximum loan guaranty percentage through March 4, 2011, or until available funding was exhausted, which occurred on January 3, 2011.

According to the SBA, the temporary fee subsidies and 90% maximum loan guaranty for the 7(a) program "engineered a significant turnaround in SBA lending.... The end result is that the agency helped put more than $42 billion in the hands of small businesses through the Recovery Act and Jobs Act combined."[7]

This report focuses on the SBLF. It begins with a discussion of the supply and demand for small business loans. The SBLF's advocates argued that the fund was an important part of a larger effort to enhance the supply of small business loans. After describing the program's structure, the report then examines other arguments that were presented both for and against the program's enactment. Advocates claimed the SBLF would increase lending to small businesses and, in turn, create jobs. Opponents contended that the SBLF could lose money, lacked sufficient oversight provisions, did not require lenders to increase their lending to small businesses, could serve as a vehicle for the Troubled Asset Relief Program (TARP) recipients to effectively refinance their TARP loans on more favorable terms with little or no resulting benefit for small businesses, and could encourage a failing lender to make even riskier loans to avoid higher dividend payments.

The report concludes with an examination of the SBLF's implementation by the Department of the Treasury and a discussion of bills introduced during the 112th and 113th Congresses to amend the SBLF. For example, during the 112th Congress, S. 681, the Greater Accountability in the Lending Fund Act of 2011, would have, among other provisions, limited the program's authority to 15 years from enactment and prohibited TARP recipients from participating in the program.

[7] SBA, "Jobs Act Supported More Than $12 Billion in SBA Lending to Small Businesses in Just Three Months," January 3, 2010, at http://www.sba.gov/content/jobs-act-supported-more-12-billion-sba-lending-small-businesses-just-three-months.

H.R. 2807, the Small Business Leg-Up Act of 2011, would have transferred any unobligated and repaid funds from the SBLF when its investment authority expired on September 27, 2011, to the Community Development Financial Institutions Fund "to continue the program of making capital investments in eligible community development financial institutions in order to increase the availability of credit for small businesses."[8] H.R. 3147, the Small Business Lending Extension Act, would have, among other provisions, extended the Treasury Department's investment authority from one year following the date of enactment to two years. During the 113th Congress, H.R. 2474, the Community Lending and Small Business Jobs Act of 2013, would transfer any unobligated and repaid funds from the SBLF to the Community Development Financial Institutions Fund.

Three Indicators of the Supply and Demand for Small Business Loans

Federal Reserve Board: Survey of Senior Loan Officers

Each quarter, the Federal Reserve Board surveys senior loan officers concerning their bank's lending practices. The survey includes questions about both the supply and demand for small business loans. For example, the survey includes a question concerning their bank's credit standards for small business loans: "Over the past three months, how have your bank's credit standards for approving applications for C&I [commercial and industrial] loans or credit lines—other than those to be used to finance mergers and acquisitions—for small firms (defined as having annual sales of less than $50 million) changed?" The senior loan officers are asked to indicate if their bank's credit standards have "Tightened considerably," "Tightened somewhat," "Remained basically unchanged," "Eased somewhat," or "Eased considerably." Subtracting the percentage of respondents reporting "Eased somewhat" and "Eased considerably" from the percentage of respondents reporting "Tightened considerably" and "Tightened somewhat" provides an indication of the market's supply of small business loans.

As shown in **Figure 1**, senior loan officers reported that they tightened small business loan credit standards during the early 2000s, loosened them during the mid-2000s, and tightened them during the late 2000s. Since 2009, small business credit markets have improved and most senior loan officers report that they are no longer tightening their small business lending standards.

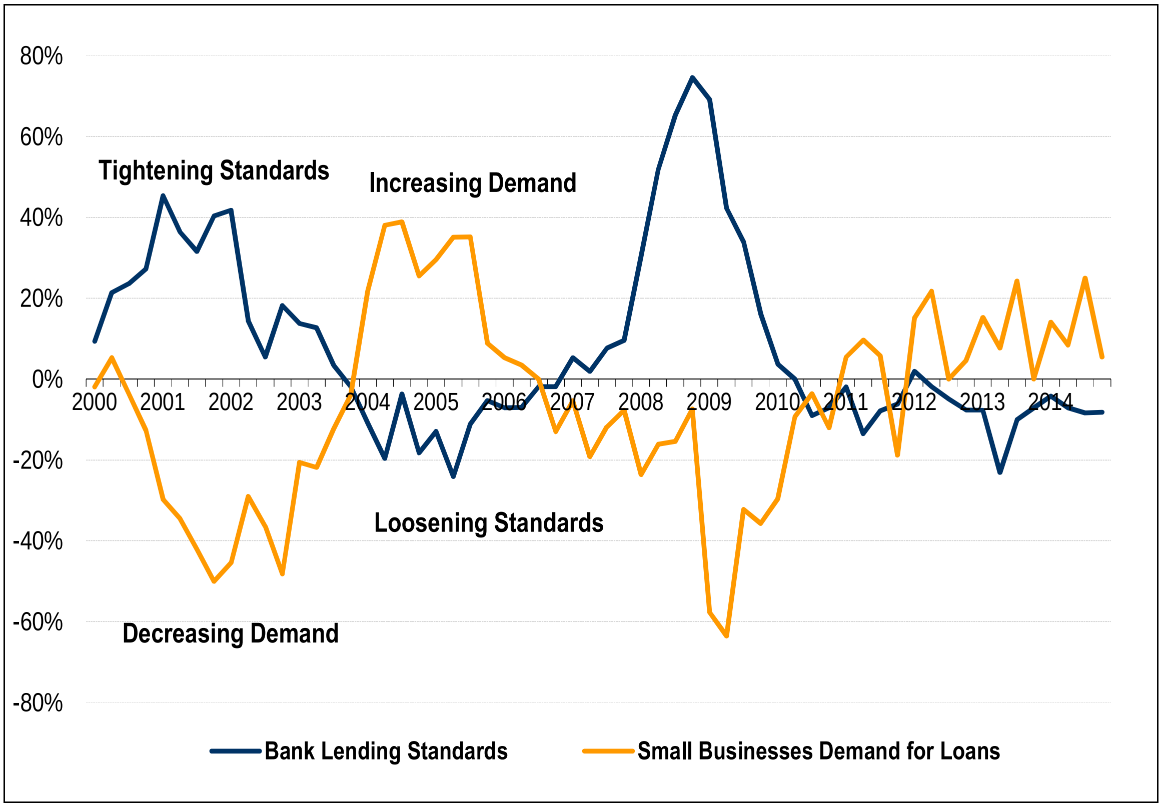
The survey also includes a question concerning the demand for small business loans: "Apart from normal seasonal variation, how has demand for C&I loans changed over the past three months for small firms (annual sales of less than $50 million)?" Senior loan officers are asked to indicate if demand was "Substantially stronger," "Moderately stronger," "About the same," "Moderately weaker," or "Substantially weaker." Subtracting the percentage of respondents reporting "Moderately weaker" and "Substantially weaker" from the percentage of respondents reporting "Substantially stronger" and "Moderately stronger" provides an indication of the market's demand for small business loans.

[8] H.R. 2807, the Small Business Leg-Up Act of 2011.

As shown in **Figure 1**, senior loan officers reported that the demand for small business loans declined from 2000 to 2004, increased from 2004 to late 2006, declined somewhat in 2007 and 2008, and declined significantly in 2009. Demand then leveled off (at a relatively reduced level) during 2010, increased somewhat during the first half of 2011, declined somewhat during the latter half of 2011, and has generally increased since then.[9]

Figure 1. Small Business Lending Environment, 2000-2014

(senior loan officers' survey responses)



Source: Federal Reserve Board, "Senior Loan Officer Opinion Survey on Bank Lending Practices," at http://www.federalreserve.gov/boarddocs/SnLoanSurvey/; and Brian Headd, "Forum Seeks Solutions To Thaw Frozen Small Business Credit," The Small Business Advocate, vol. 28, no. 10 (December 2009), p. 3, at http://www.sba.gov/sites/default/files/The%20Small%20Business%20Advocate%20-%20December%202009.pdf.

Federal Deposit Insurance Corporation: Outstanding Loan Balance

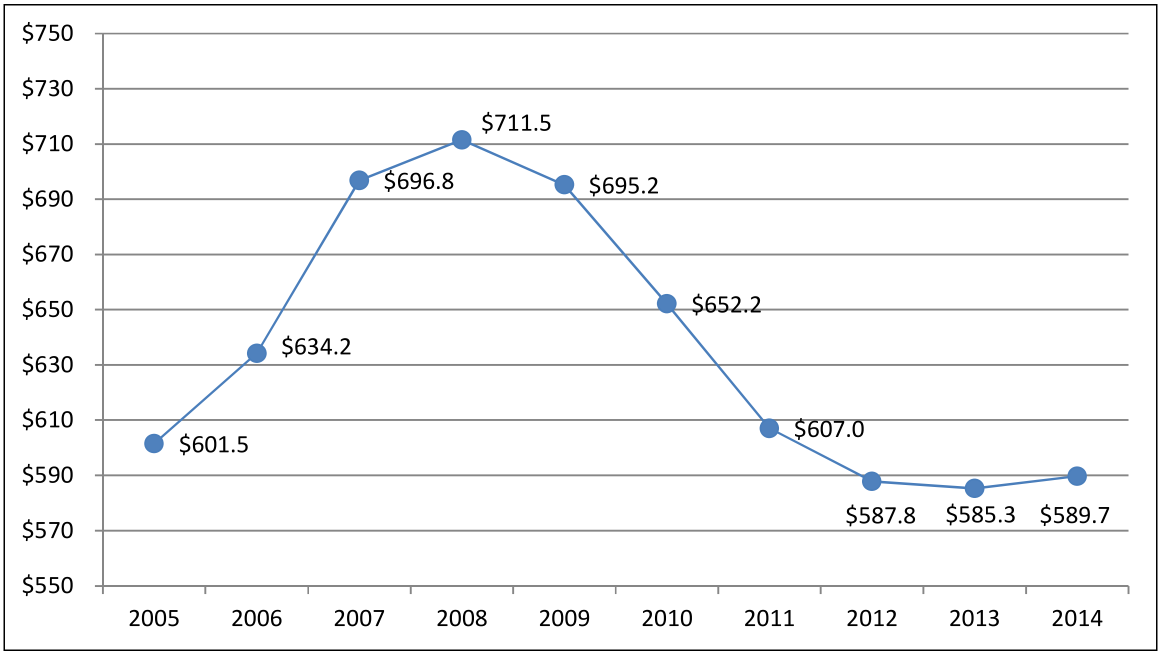
The Federal Deposit Insurance Corporation (FDIC) has maintained comparable small business lending data for the second quarter (June 30) of each year since 2002. **Figure 2** shows the amount of outstanding small business loans (defined by the FDIC as commercial and industrial loans of $1 million or less) for non-agricultural purposes as of June 30 of each year since 2005. As shown in **Figure 2**, the amount of outstanding small business loans for non-agricultural purposes

[9] Federal Reserve Board, "Senior Loan Officer Opinion Survey on Bank Lending Practices," at http://www.federalreserve.gov/boarddocs/SnLoanSurvey/.

increased at a relatively steady pace from June 30, 2005, to June 30, 2008, declined over the next several years, and has remained about the same since June 30, 2012.

Figure 2. Outstanding Small Business Loans, Non-Agricultural Purposes, 2005-2014

(billions of dollars)



Source: Federal Deposit Insurance Corporation, "Statistics on Depository Institutions," at http://www2.fdic.gov/SDI/main.asp.

Notes: Data as of June 30 each year.

Although changes in small business outstanding debt are not necessarily a result of changes in the supply of small business loans, many, including the SBA, view a decline in small business outstanding debt as a signal that small businesses might be experiencing difficulty accessing sufficient capital to enable them to lead job growth during the current recovery.

Federal Reserve Board: Survey of Commercial Banks

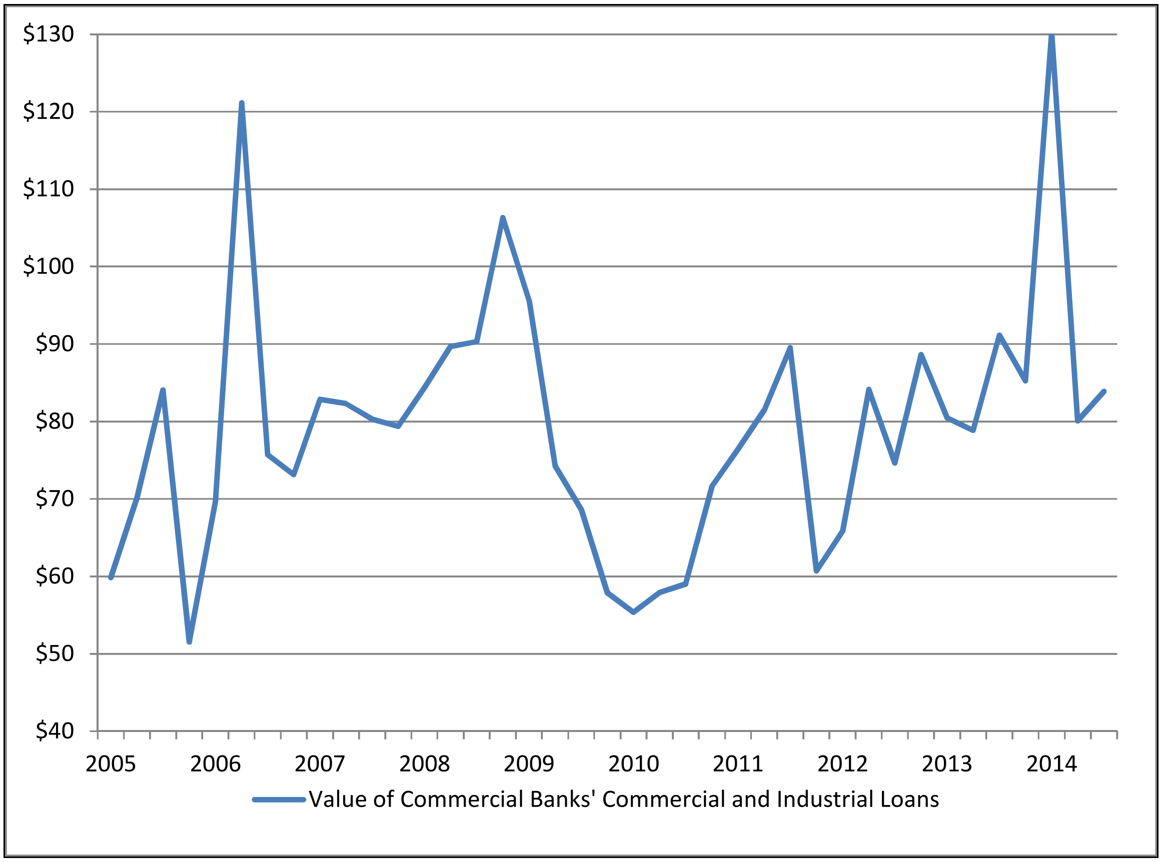
The Federal Reserve Board conducts a quarterly "Survey of Terms of Business Lending" that provides information concerning the lending activity of commercial banks during the first full business week in the middle month of each quarter.[10] As shown in **Figure 3**, the Federal Reserve Board data indicate that the total estimated value of commercial and industrial loans (hereinafter C&I loans) provided by the commercial banks responding to the survey has experienced some volatility over the years, with relatively steep declines during the latter half of the December 2007-June 2009 recession and immediately following the recession. **Figure 3** also shows that the

[10] The authorized panel size for the Survey of Terms of Business Lending is 348 domestically chartered commercial banks and 50 U.S. branches and agencies of foreign banks. The sample data are used to estimate the terms of loans extended during that week at all domestic commercial banks and all U.S. branches and agencies of foreign banks. See Board of Governors of the Federal Reserve System, "Survey of Terms of Business Lending - E.2, August 4-8, 2014," at http://www.federalreserve.gov/releases/E2/current/default.htm.

total estimated value of these commercial banks' C&I loans has generally increased since the recession's end. During the week of August 4-8, 2014 (the latest available data), the estimated value of these commercial banks' C&I loans was $83.9 billion.

Figure 3. Estimated Value of Commercial and Industrial Loans Made By Commercial Banks on a Quarterly Basis, 2005-2014

(billions of dollars)



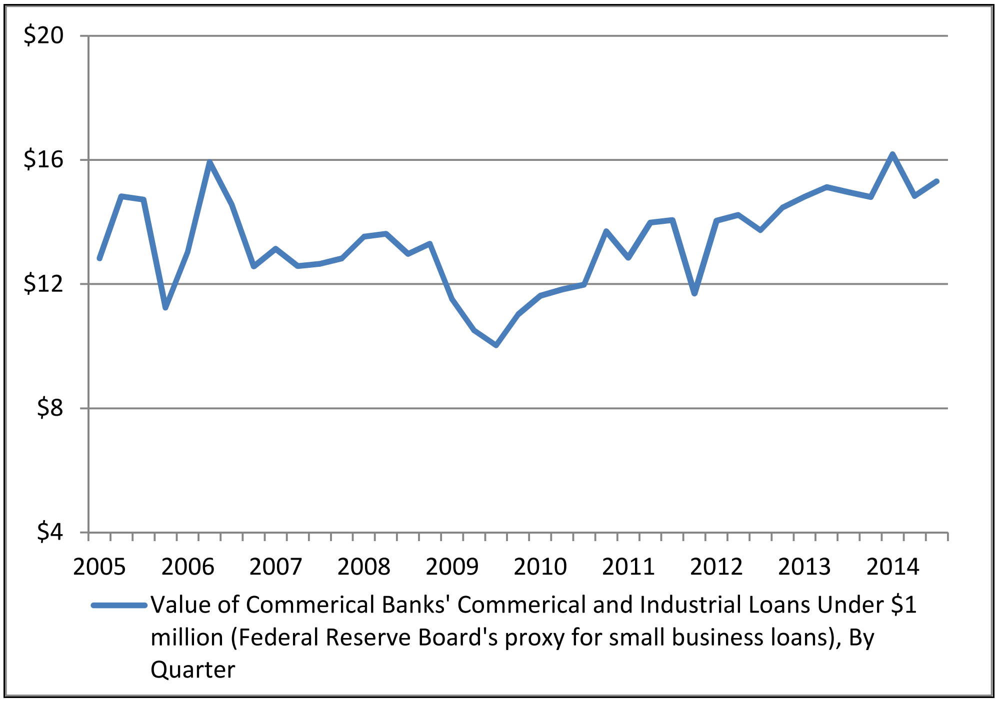
Source: Board of Governors of the Federal Reserve System, "Survey of Terms of Business Lending - E.2," at http://www.federalreserve.gov/releases/E2/default.htm.

Notes: The data were collected during the first full business week in the middle month of each quarter. Value is the amount borrowed.

As shown in **Figure 4**, the data also indicate that the estimated value of the surveyed commercial banks' small business loans (defined by the Federal Reserve Board as a C&I loan under $1 million) has also shown some volatility, ranging from a low of $10.0 billion during the week of August 3-7, 2009, to a high of $16.2 billion during the week of February 3-7, 2014. During the week of August 4-8, 2014 (the latest available data), the estimated value of the surveyed commercial banks' small business loans was $15.3 billion.

Figure 4. Estimated Value of Commercial and Industrial Loans Made By Commercial Banks in Amounts Under $1 Million, on a Quarterly Basis, 2005-2014

(billions of dollars)



Source: Board of Governors of the Federal Reserve System, "Survey of Terms of Business Lending - E.2," at http://www.federalreserve.gov/releases/E2/default.htm.

Notes: The data were collected during the first full business week in the middle month of each quarter. Value is the amount borrowed.

Factors that May Have Contributed to the Decline in the Supply of Small Business Loans in 2007-2010

According to an SBA-sponsored study of small business lending, several factors contributed to the decline in small business lending from 2007 to 2010.[11] The report's authors noted that the 30% decline in home prices from their peak in 2006 to 2010 diminished the value of collateral for many small business borrowers, some of whom had relied on home equity loans to finance their small businesses during the real estate boom. The authors concluded that the absence of this additional source of collateral may have contributed to a decline in lending to small businesses.[12] They also argued that many small businesses found it increasingly difficult to renew existing lines of credit as lenders became more cautious as a result of slow economic growth and an increasing risk of loan defaults, especially among small business start-ups, which are generally considered among the most risky investments.[13] The authors argued that

[11] George W. Haynes and Victoria Williams, *Lending by Depository Lenders to Small Businesses, 2003 to 2010*, SBA, Office of Advocacy, March 2011, at http://www.sba.gov/sites/default/files/rs380tot.pdf.

[12] Ibid., p. 25.

[13] Ibid., p. 26. One possible contributing factor for at least some lenders becoming more cautious is that in recent years many lenders experienced an increase in nonperforming loans and a depletion of their loan loss reserves, limiting the (continued...)

- in this newly regulated market, smaller lenders are likely to be less profitable because they have fewer sales of products and services to spread out over the higher auditing and FDIC costs. Hence, they have less money to lend to small businesses and others; and
- the relative difficulty in assessing creditworthiness due to the lack of information about potential financial performance is very high in small business lending, especially in financial markets driven by factor—rather than relationship—lending. Therefore, one would expect the small business loan market to recover more slowly than other financial markets.[14]

The authors also noted that FDIC data indicated that small business lending had not only declined in absolute terms (the total amount of dollars borrowed and the total number of small business loans issued), but in relative terms as well (the market share of business loans):

> Over the eight years from 2003 through 2010, small business loans as a share of total business loans declined by more than 12 percentage points, from 81.7% in 2003 to 68.9% in 2010. Perhaps of most concern is the further decline in the ratios of small business loans to total assets and small business loans to total business loans. Small business loans constituted about 16.8% of total assets in 2005, but only 15.3% in 2010; hence, small business lending is becoming less significant for these lenders. Small business lending is also losing market share in the business loan market. In the eight-year period from 2003 to 2010, small business loans as a share of total business loans declined more than 10 percentage points from 81.7% in 2003 to 68.9% in 2010.[15]

Factors that May Have Contributed to the Decline in the Demand for Small Business Loans in 2007-2010

According to the previously mentioned SBA-sponsored study of small business lending, the demand for small business loans fell during the recession primarily because many small businesses experienced a decline in sales and many small business owners had a heightened level of uncertainty concerning future sales. The study's authors argued that given small business owners' lack of confidence in the demand for their goods and services, many small business owners decided to save capital instead of hiring additional employees and borrowing capital to invest in business expansions and inventory.[16]

The responses of small business owners to a monthly survey by the National Federation of Independent Business Research Foundation (NFIB) concerning small business owner's views of the economy support the argument that declining sales contributed to the reduced demand for small business loans. Since 2008, small business owners responding to the NFIB surveys have identified poor sales as their number-one problem. Prior to 2008, taxes had been reported as their number-one problem in nearly every survey since the monthly surveys began in 1986.[17] Also,

(...continued)

funds available for lending to small businesses.

[14] Ibid., p. 26.

[15] Ibid., p. 25.

[16] Ibid.

[17] William C. Dunkelberg and Holly Wade, *Small Business Economic Trends* (Washington, DC: NFIB Research (continued...)

employment data suggest that small businesses were particularly hard hit by the recession. As mentioned previously, small businesses accounted for almost 60% of the net job losses during the December 2007-June 2009 recession.[18]

According to testimony by the Secretary of the Treasury before the House Small Business Committee on June 22, 2011, small businesses were especially hard hit by the recession because

> [s]mall businesses are concentrated in sectors that were especially hard hit by the recession and the bursting of the housing bubble: construction and real estate. More than one-third of all construction workers are employed by firms with less than 20 workers, and an additional third are employed by businesses with fewer than 100 employees. Just over half of those employed in the real estate, rental, and leasing sectors work for businesses with less than 100 workers on their payrolls. More broadly, the rate of job losses was almost twice as high in small businesses as it was in larger firms during the depths of the crisis.[19]

The Congressional Response to the Decline in the Supply and Demand for Small Business Loans

During the 111th Congress, legislation designed to increase both the supply and demand for small business loans was adopted. For example, Congress provided more than $1.1 billion to temporarily subsidize fees for the SBA's 7(a) and 504/Certified Development Company (504/CDC) loan guaranty programs and to increase the 7(a) program's maximum loan guaranty percentage from 85% on loans of $150,000 or less and 75% on loans exceeding $150,000 to 90% for all regular 7(a) loans (funding was exhausted on January 3, 2011).[20] The fee subsidies were

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Foundation, September 2011), p. 18, at http://www.nfib.com/Portals/0/PDF/sbet/sbet201109.pdf; and William J. Dennis, Jr., *Small Business Credit in a Deep Recession* (Washington, DC: NFIB Research Foundation, June 2008), p. 1, at http://www.nfib.com/LinkClick.aspx?fileticket=IPeviHUzXfE%3D&tabid=90&mid=3121.

[18] SBA, "The Small Business Economy, 2010: A Report to the President," pp. 2, 5, 21, 22, at http://www.sba.gov/sites/default/files/sb_econ2010.pdf; and SBA, *Fiscal Year 2010 Congressional Budget Justification*, p. 1, at http://www.sba.gov/sites/default/files/Congressional_Budget_Justification_2010.pdf.

[19] U.S. Congress, House Committee on Small Business, *The State of Small Business Access to Capital and Credit: The View from Secretary Geithner*, 112th Cong., 1st sess., June 22, 2011, p. 1.

[20] P.L. 111-5, the American Recovery and Reinvestment Act of 2009, provided the SBA $375 million to subsidize fees for the SBA's 7(a) and 504/CDC loan guaranty programs and to increase the 7(a) program's maximum loan guaranty percentage from up to 85% of loans of $150,000 or less and up to 75% of loans exceeding $150,000 to 90% for all regular 7(a) loans through September 30, 2010, or when appropriated funding for the subsidies and loan modification was exhausted. P.L. 111-118, the Department of Defense Appropriations Act, 2010, provided the SBA $125 million to continue the fee subsides and 90% maximum loan guaranty percentage through February 28, 2010. P.L. 111-144, the Temporary Extension Act of 2010, provided the SBA $60 million to continue the fee subsides and 90% maximum loan guaranty percentage through March 28, 2010. P.L. 111-150, an act to extend the Small Business Loan Guarantee Program, and for other purposes, provided the SBA authority to reprogram $40 million in previously appropriated funds to continue the fee subsides and 90% maximum loan guaranty percentage through April 30, 2010. P.L. 111-157, the Continuing Extension Act of 2010, provided the SBA $80 million to continue the SBA's fee subsides and 90% maximum loan guaranty percentage through May 31, 2010. P.L. 111-240, the Small Business Jobs Act of 2010, provided $505 million (plus an additional $5 million for administrative expenses) to continue the SBA's fee subsides and 90% maximum loan guaranty percentage from the act's date of enactment (September 27, 2010) through December 31, 2010. P.L. 111-322, the Continuing Appropriations and Surface Transportation Extensions Act, 2011, authorizes the SBA to use funds provided under the Small Business Jobs Act of 2010 to continue the SBA's fee subsides and 90% maximum loan guaranty percentage through March 4, 2011, or until available funding is exhausted—which occurred on January 3, 2011.

designed to increase the demand for small business loans by reducing the cost of borrowing. The 90% loan guarantee was designed to increase the supply of small business loans by reducing the risk of lending.

Congress also provided the SBA additional resources to expand its lending to small businesses. For example, ARRA included a $255 million temporary, two-year small business stabilization program to guarantee loans of $35,000 or less to small businesses for qualified debt consolidation, later named the America's Recovery Capital (ARC) Loan program (the program ceased issuing new loan guarantees on September 30, 2010); an additional $15 million for the SBA's surety bond program and a temporary increase in that program's maximum bond amount from $2 million to $5 million and up to $10 million under certain conditions (the higher maximum bond amounts ended on September 30, 2010); an additional $6 million for the SBA's Microloan program's lending program and an additional $24 million for the Microloan program's technical assistance program; and increased the funds (*leverage*) available to SBA-licensed Small Business Investment Companies (SBICs) to no more than 300% of the company's private capital or $150 million, whichever is less.[21]

Several other programs were also enacted during the 111th Congress to increase the supply of small business loans. For example, ARRA authorized the SBA to establish a temporary secondary market guarantee authority to provide a federal guarantee for pools of first lien 504/CDC program loans that are to be sold to third-party investors. ARRA also authorized the SBA to make below-market interest rate direct loans to SBA-designated "Systemically Important Secondary Market (SISM) Broker-Dealers" that would use the loan funds to purchase SBA-guaranteed loans from commercial lenders, assemble them into pools, and sell them to investors in the secondary loan market.[22]

P.L. 111-240 extended the SBA's secondary market guarantee authority from two years after the date of ARRA's enactment to two years after the date of the program's first sale of a pool of first lien position 504/CDC loans to a third-party investor (which took place on September 24, 2010).[23] The act also increased the loan guarantee limits for the SBA's 7(a) program from $2 million to $5 million, and for the 504/CDC program from $1.5 million to $5 million for "regular" borrowers, from $2 million to $5 million if the loan proceeds are directed toward one or more specified public policy goals, and from $4 million to $5.5 million for manufacturers. It also increased the SBA's Microloan program's loan limit for borrowers from $35,000 to $50,000 and for microlender intermediaries after their first year in the program from $3.5 million to $5 million.[24] In addition, it temporarily increased for one year (through September 26, 2011) the SBA 7(a) Express Program's loan limit from $350,000 to $1 million. The act also authorized the Secretary of the Treasury to establish the $30 billion SBLF and a $1.5 billion State Small Business Credit Initiative to provide funding to participating states with small business capital access programs.

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[21] P.L. 111-5, the American Recovery and Reinvestment Act of 2009, §505, Increasing Small Business Investment.

[22] Ibid.

[23] SBA, Office of Congressional and Legislative Affairs, correspondence with the author, January 4, 2010.

[24] The act also temporarily allowed the SBA to waive, in whole or in part, for successive fiscal years, the non-federal share requirement for loans to the Microloan program's intermediaries and for grants made to Microloan intermediaries for small business marketing, management, and technical assistance under specified circumstances (e.g., the economic conditions affecting the intermediary). See P.L. 111-240, the Small Business Jobs Act of 2010, §1401. Matching Requirements Under Small Business Programs.

The SBLF

The SBLF was designed "to address the ongoing effects of the financial crisis on small businesses by providing temporary authority to the Secretary of the Treasury to make capital investments in eligible institutions in order to increase the availability of credit for small businesses."[25] The SBLF's legislative history, including differences in the House- and Senate-passed versions of the program, appears in the **Appendix**.

P.L. 111-240 authorized the Secretary of the Treasury to make up to $30 billion in capital investments in eligible institutions with total assets equal to or less than $1 billion or $10 billion (as of the end of the fourth quarter of calendar year 2009).[26] The authority to make capital investments in eligible institutions was limited to one year after enactment.

Eligible financial institutions with total assets equal to or less than $1 billion as of the end of the fourth quarter of calendar year 2009 could apply to receive a capital investment from the SBLF in an amount not exceeding 5% of risk-weighted assets, as reported in the FDIC call report immediately preceding the date of application. During the fourth quarter of 2009, 7,340 FDIC-insured lending institutions reported having assets amounting to less than $1 billion.[27]

Eligible financial institutions with total assets equal to or less than $10 billion as of the end of the fourth quarter of calendar year 2009 could apply to receive a capital investment from the fund in an amount not exceeding 3% of risk-weighted assets, as reported in the FDIC call report immediately preceding the date of application. During the fourth quarter of 2009, 565 FDIC-insured lending institutions reported having assets of $1 billion to $10 billion.[28]

Risk-weighted assets are assets such as cash, loans, investments, and other financial institution assets that have different risks associated with them. FDIC regulations (12 C.F.R. §567.6) establish that cash and government bonds have a 0% risk-weighting; residential mortgage loans have a 50% risk-weighting; and other types of assets (such as small business loans) have a higher risk-weighting.[29]

Lending institutions on the FDIC problem bank list or institutions that have been removed from the FDIC problem bank list for less than 90 days are ineligible to participate in the program. A lending institution can refinance securities issued through the Treasury Capital Purchase Program

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[25] P.L. 111-240, the Small Business Jobs Act of 2010, §4101, Purpose. In 2011, there were 7,513 FDIC-insured lending institutions in the United States. Of that number, 6,846 lending institutions had assets amounting to less than $1 billion (totaling $1.42 trillion), 561 lending institutions had assets of $1 billion to $10 billion (totaling $1.43 trillion), and 106 lending institutions had assets greater than $10 billion (totaling $10.76 trillion). See FDIC, "Quarterly Banking Profile: Second Quarter 2011," at http://www2.fdic.gov/qbp/2011jun/qbp.pdf.

[26] Eligible institutions may be insured depository institutions that are not controlled by a bank holding company or a savings and loan holding company that is also an eligible institution and is not directly or indirectly controlled by any company or other entity that has total consolidated assets of more than $10 billion, bank holding companies, savings and loan holding companies, and community development financial institution loan funds, all with total assets of $10 billion or less (as of the end of 2009).

[27] FDIC, "Quarterly Banking Profile: Fourth Quarter 2009," at http://www2.fdic.gov/qbp/2009dec/qbp.pdf.

[28] Ibid. In the fourth quarter of 2009, 107 FDIC-insured lending institutions had assets greater than $10 billion.

[29] For further analysis of risk-weighted assets, see CRS Report R40249, *Who Regulates Whom? An Overview of U.S. Financial Supervision*, by Edward V. Murphy.

(CPP) and the Community Development Capital Incentive (CDCI) program under TARP, but only if that institution had not missed more than one dividend payment due under those programs.

Participating banks are charged a dividend rate of 5% per annum initially, with reduced rates available if the bank increases its small business lending by specified amounts. For example, during any calendar quarter in the initial two years of the capital investments under the program, the bank's dividend rate is lowered if it increases its small business lending, as reported in its FDIC call reports, compared with the average small business lending it made in the four previous quarters immediately preceding the law's enactment, minus some allowable adjustments.[30] A 2.5% to 5% increase in small business lending lowers the rate to 4%, a 5% to 7.5% increase lowers the rate to 3%, a 7.5% to 10% increase lowers the rate to 2%, and an increase greater than 10% lowers the rate to 1%. **Table 1** shows the dividend rates associated with small business lending increases by financial institutions.

Table 1. Small Business Lending Increases and Dividend Rates Under the Small Business Lending Fund (SBLF)

Small Business Lending Increase	Dividend Rate
10% or greater	1%
At least 7.5% but less than 10%	2%
At least 5% but less than 7.5%	3%
At least 2.5% but less than 5%	4%
Less than 2.5%	5%
No increase	7%

Source: P.L. 111-240, the Small Business Jobs Act of 2010, Section 4103. Small Business Lending Fund.

Note: The dividend rate increases to 9% at the end of the five-year period that begins on the date of the capital investment under the program.

SBLF applicants are required to submit a small business lending plan to the appropriate federal banking agency and, for applicants that are state-chartered banks, to the appropriate state banking regulator. The plan must describe how the applicant's business strategy and operating goals will allow it to address the needs of small businesses in the areas it serves, as well as a plan to provide linguistically and culturally appropriate outreach, where appropriate. The plan is treated as confidential supervisory information. The Secretary of the Treasury is required to consult with the appropriate federal banking agency or, in the case of an eligible institution that is a non-depository community development financial institution, the Community Development Financial Institution Fund, before determining if the eligible institution may participate in the program.[31]

[30] The FDIC defines a small business loan as a loan of $1 million or less. P.L. 111-240 specified that small business lending included 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. Loans that have an original amount greater than $10 million, or that go to a business with more than $50 million in revenues, are not allowed.

[31] If the appropriate banking agency would not otherwise recommend that the eligible institution receive the capital investment, the Secretary of the Treasury was authorized, in consultation with the appropriate banking agency, to consider allowing the eligible institution to participate in the program if the eligible institution provided matching capital from private, nongovernmental sources that is equal to or greater than 100% of the SBLF investment and if that matching capital is subordinate to the capital investment from the SBLF.

The act directed that all funds received by the Secretary of the Treasury in connection with purchases made by the SBLF, "including interest payments, dividend payments, and proceeds from the sale of any financial instrument, shall be paid into the general fund of the Treasury for reduction of the public debt."[32]

Arguments For and Against the SBLF

The SBLF's advocates argued that it would create jobs by encouraging lenders, especially those experiencing liquidity problems (access to cash and easily tradable assets),[33] to increase their lending to small businesses. For example, the House report accompanying H.R. 5297, the Small Business Lending Fund Act of 2010, argued that the SBLF was needed to enhance small business's access to capital, which, in turn, was necessary to enable those businesses to create jobs and assist in the economic recovery:

> There has been a dramatic decrease in the amount of bank lending in the past several quarters. On May 20, 2010, the Federal Deposit Insurance Corporation (FDIC) released its Quarterly Banking Profile for the first quarter of 2010. The report shows that commercial and industrial loans declined for the seventh straight quarter, down more than 17% from the year before.
>
> Many companies, particularly small businesses, claim that it is becoming harder to get new loans to keep their business operating and that banks are tightening requirements or cutting off existing lines of credit even when the businesses are up to date on their loan repayments. Treasury Secretary Timothy F. Geithner recently acknowledged the problem encountered by some banks, both healthy and troubled, which have been told to maintain capital levels in excess of those required to be considered well capitalized.
>
> Some banks say they have little choice but to scale back lending, even to creditworthy borrowers, and the most recent Federal Reserve data shows banks are continuing to tighten lending terms for small businesses.[34]

A dissenting view, endorsed by the House Committee on Financial Services' minority members, was included in the report. This view argued that the SBLF does not properly deal with the lack of financing for small businesses:

> Instead of addressing the problem by stimulating demand for credit by small businesses, H.R. 5297 injects capital into banks with no guarantees that they will actually lend. The bill allows a qualifying bank to obtain a capital infusion from the government without even requiring the bank to make a loan for two years. In fact, if a bank reduces or fails to increase

[32] P.L. 111-240, the Small Business Jobs Act of 2010, §4103. Small Business Lending Fund. Using a cost-based estimate, the Congressional Budget Office (CBO) estimated that the SBLF would result in net outlays of $3.3 billion over 2010-2015 and would reduce outlays by $1.1 billion over the 2010-2020 period. Using an alternative fair-value estimate, CBO estimated that the SBLF would result in net outlays of $6.2 billion over the 2010-2020 time period. See CBO, "Cost Estimate: H.R. 5297, Small Business Lending Fund Act of 2010," June 28, 2010, pp. 3, 4, at http://www.cbo.gov/ftpdocs/115xx/doc11595/hr5297_HousePassed.pdf.

[33] For further information and analysis concerning lender liquidity issues, see CRS Report R41073, *Government Interventions in Response to Financial Turmoil*, by Baird Webel and Marc Labonte.

[34] H.Rept. 111-499, To Create the Small Business Lending Fund Program to Direct the Secretary of the Treasury to Make Capital Investments in Eligible Institutions in order to Increase the Availability of Credit for Small Businesses, and for other purposes, p. 16.

> lending to small business during those first two years, it would not face any penalty. It defies logic that the Majority would support a bill to increase lending that does not actually require increased lending. A more effective response to the challenges facing America's small businesses was offered by Representatives Biggert, Paulsen, Castle, Gerlach, and King, whose amendment would have extended a series of small business tax credits before implementing the Small Business Lending Fund.[35]

Advocates also argued that even if the SBLF were authorized "the program probably would not be fully operational for months; banks could shun the program for fear of being stigmatized by its association with TARP; and many banks would avoid taking on new liabilities when their existing assets are troubled."[36] They contended that the bill did not provide sufficient oversight for effectively monitoring the program because the Inspector General of the Department of the Treasury, who was given that oversight responsibility under the bill, "might not be able to direct sufficient attention to this task given its other responsibilities."[37] They argued that the Special Inspector General of TARP would be in a better position to provide effective oversight of the program.[38]

These, and other, arguments were presented during House floor debate on the bill. For example, Representative Melissa Bean advocated the bill's passage, arguing that the SBLF

> builds on the effective financial stabilization measures Congress has previously taken by establishing a new $30 billion small business loan fund to provide additional capital to community banks that increase lending to small businesses. This $30 billion investment on which the government will be collecting dividends and earning a profit per the CBO [Congressional Budget Office] estimates can be leveraged by banks into over $300 billion in new small business loans. This is an important investment by the Federal Government in our small business that brings tremendous returns.
>
> The terms of the capital provided to banks are performance based; the more a bank increases its small business lending, the lower the dividend rate is for the SBLF capital. If a bank decreases its small business lending, it will be penalized with higher dividend rates.
>
> This legislation includes strong safeguards to ensure that banks adequately utilize available funds to increase lending to small businesses, not for other lending or to improve their balance sheet. There will be oversight consistently throughout the program, plus it requires that the capital be invested only in strong financial institutions at little risk of default and the best positioned to increase small business lending.
>
> It's important for Americans to understand that although this fund has a maximum value of $30 billion, it is estimated to make a profit for taxpayers in the long run. And the money will ultimately go not to banks, but to the small businesses and their communities that they lend to. As our financial system stabilizes and our community banks recapitalize, these funds will be repaid to Treasury with full repayment required over the next 10 years.[39]

[35] Ibid., p. 37.

[36] Ibid., pp. 37, 38.

[37] Ibid., p. 38.

[38] Ibid.

[39] Representative Melissa Bean, "Consideration of the Small Business Jobs and Credit Act of 2010," House debate, *Congressional Record*, daily edition, vol. 156, no. 90 (June 16, 2010), p. H4514.

Representative Nydia Velázquez, then-chair of the House Committee on Small Business, added that the legislation had sufficient safeguards in place to ensure that the funds were targeted at small businesses:

> First, banks must apply to the Treasury to receive funds, with a detailed plan on how to increase small business lending at their institution. This language was included at my insistence that we need to make sure that small businesses will get the benefit of this legislation.
>
> Second, this capital, repayment of the government loans will be at a dividend rate starting at 5% per year. This rate will be lowered by 1% for every 2.5% increase in small business lending over 2009 levels. It can go as low as a total dividend rate of just 1% if the bank increases its business lending by 10% or more, incentivizing banks to do the right thing. To ensure that banks actually use the funding they receive, the rate will increase—and there are penalties—to 7% if the bank fails to increase its small business lending at their institution within 2 years. To ensure that all federal funds are paid back within 5 years, the dividend rate will increase to 9% for all banks, irrespective of their small business lending, after 4 1/2 years.[40]

Representative Velázquez added "let me just make it clear … CBO estimates that [the SBLF] will save taxpayers $1 billion over 10 years, as banks are expected to pay back this loan over 10 years, with interest."[41]

Representative Randy Neugebauer opposed the bill's adoption, arguing that

> the majority is repeating the same failed initiatives that have helped our national debt grow to $13 trillion in the past 2 years. This bill follows the model of the TARP program, minus [TARP's] stronger oversight, and it puts another $30 billion into banks in the hopes that lending to small businesses will increase. In the words of Neil Barofsky, the Special Inspector General who oversees the TARP, "In terms of its basic design," he says, "its participants, its application process, from an oversight perspective, the Small Business Lending Fund would essentially be an extension of the TARP's Capital Purchase Program." From the Congressional Oversight Panel for TARP, chaired by Elizabeth Warren, she says, "The SBLF's prospects are far from certain. The SBLF also raises questions about whether, in light of the Capital Purchase Program's poor performance in improving credit access, any capital infusion program can successfully jump-start small business lending."
>
> This bill allows for another $33 billion in spending that will be added to the government's credit card. The CBO tells us that the bank lending portion will ultimately cost taxpayers $3.4 billion when market risk is taken into account.[42]

The House passed H.R. 5297 by a vote of 241-182, on June 17, 2010.

The arguments presented during House floor debate on H.R. 5297 were also presented during Senate consideration of the bill. Advocates argued that the SBLF would encourage higher levels of small business lending and jobs. For example, Senator Mary Landrieu argued on July 21, 2010,

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[40] Representative Nydia Velázquez, "Consideration of the Small Business Jobs and Credit Act of 2010," House debate, *Congressional Record*, daily edition, vol. 156, no. 90 (June 16, 2010), p. H4518.

[41] Ibid.

[42] Representative Randy Neugebauer, "Consideration of the Small Business Jobs and Credit Act of 2010," House debate, *Congressional Record*, daily edition, vol. 156, no. 90 (June 16, 2010), p. H4515.

that the SBLF should be adopted because it "is not a government program for banks. It is a public-private partnership lending strategy for small business."[43] She added that as chair of the Senate Committee on Small Business and Entrepreneurship, she talked with her colleagues, including the SBLF's opponents, and revised the program to address their concerns. She also argued that the SBLF has

> hundreds of endorsements from independent banks, the community banks and almost every small business association in America … makes $1 billion [according to the CBO score] … is not direct lending from the federal government. It is not creating a new bureaucracy … [It is] voluntary … there are no onerous restrictions.… The small business gets the loans. We create jobs. People are employed. The recession starts ending…. It has nothing to do with TARP money. It is not a TARP program. It is not a bank program. It doesn't have anything to do with banks except that we are working in partnership with banks to lend money to small businesses which are desperate for money.[44]

Opponents argued that the SBLF could lose money, lacked sufficient oversight provisions, did not require lenders to increase their lending to small businesses, could serve as a vehicle for TARP recipients to effectively refinance their TARP loans on more favorable terms with little or no resulting benefit for small businesses, and could encourage a failing lender to make even riskier loans to avoid higher dividend payments. In addition, there were disagreements over the number of amendments that could be offered by the minority, which led several Senators to oppose further consideration of the bill until that issue was resolved to their satisfaction. For example, on July 22, 2010, Senator Olympia Snowe argued that although "under a cash-based estimate, CBO listed the official score for the lending fund as raising $1.1 billion over 10 years," SBLF proponents "fail to mention" that when CBO scored the SBLF using an alternative methodology that adjusts for market risk, it estimated that the SBLF could cost $6.2 billion.[45] Senator Snowe also argued that the bipartisan Congressional Oversight Panel for TARP stated in its May 2010 oversight report that the proposed SBLF "substantially resembles" the TARP and "is a bank-focused capital infusion program that is being contemplated despite little, if any, evidence that such programs increase lending."[46] Senator Snowe noted that she regretted "that we are in a position where we have not been able to reach agreement allowing the minority to offer amendments, which is confounding and perplexing as well as disappointing."[47] Senator Snowe later added that the SBLF's incentives to encourage lending to small businesses also "could encourage unnecessarily risky behavior by banks … to avoid paying higher interest rates."[48]

Opponents also questioned the SBLF's use of quarterly call report data as submitted by lenders to their appropriate banking regulator to determine what counts as a small business loan.[49] Call report data denotes loans of $1 million or less as small business loans, regardless of the size of the

[43] Senator Mary Landrieu, "Small Business Lending," remarks in the Senate, *Congressional Record*, daily edition, vol. 156, no. 108 (July 21, 2010), p. S6070.

[44] Ibid., p. S6071.

[45] Senator Olympia Snowe, "Small Business Lending," remarks in the Senate, *Congressional Record*, daily edition, vol. 156, no. 108 (July 22, 2010), pp. S6158.

[46] Ibid.

[47] Ibid., p. S6156.

[48] Senator Olympia Snowe, "Small Business Lending Fund Act of 2010," remarks in the Senate, *Congressional Record*, daily edition, vol. 156, no. 125 (September 16, 2010), pp. S7157.

[49] The act specified that the SBLF could not be used to provide loans greater than $10 million or that go to a business with more than $50 million in revenues. See P.L. 111-240, the Small Business Jobs Act of 2010, §4102. Definitions.

business receiving the loan. As a result, the SBLF's opponents argued that "the data used to measure small business lending in the SBLF covers an entirely different set of small businesses than those that fall within the definition set out in the Small Business Act or used by the SBA."[50]

The Senate's version of H.R. 5297 was agreed to on September 16, 2010, by a vote of 68-38.[51] The House agreed to the Senate-passed version of H.R. 5297 on September 23, 2010, by a vote of 237-187, and the bill, retitled the Small Business Jobs Act of 2010, was signed into law by President Obama on September 27, 2010.

The SBLF's Implementation

On February 14, 2011, the Obama Administration issued its budget recommendation for FY2012. The budget anticipated that the SBLF would provide $17.399 billion in financings, well below its authorized amount of $30 billion.[52] This was the first indication that the SBLF's implementation may not proceed as expected.[53] The second indication that the program's implementation may not proceed as expected was an unanticipated delay in the writing of the program's regulations.

Treasury's Rollout of the Program

The U.S. Treasury was criticized by some for not implementing the program quickly enough.[54] The first financing took place on June 21, 2011, about nine months after the program's enactment. The delay was largely due to the Treasury's need to finalize the SBLF's investment decision process with federal banking agencies[55] and the need to create separate SBLF regulations for

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[50] Representative Sam Graves, "Full Committee Hearing, The State of Small Business Access to Credit and Capital: The View from Secretary Geithner," Letter to Members of the House Small Business Committee, Washington, DC, June 20, 2011, p. 19, at http://smbiz.house.gov/UploadedFiles/6-22_Memo.pdf.

[51] Senator Kay Hagen, "Motion to Invoke Cloture on H.R. 5297, the Small Business Lending Fund Act of 2010," Rollcall Vote No. 236 Leg., *Congressional Record*, daily edition, vol. 156, part 125 (September 16, 2010), p. S7158; and Senator Al Franken, "Small Business Lending Fund Act of 2010," Rollcall Vote No. 237 Leg., *Congressional Record*, daily edition, vol. 156, part 125 (September 16, 2010), p. S7158.

[52] U.S. Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2012, Appendix: Department of the Treasury*, p. 989, at http://www.whitehouse.gov/sites/default/files/omb/budget/fy2012/assets/tre.pdf.

[53] The Department of the Treasury based its forecast on an "analysis of demand for the program." See U.S. Department of the Treasury, "FY2012 Congressional Justification, Small Business Lending Fund," p. 7, at http://www.treasury.gov/about/budget-performance/Documents/CJ_FY2012_SBLF_508.pdf.

[54] Representative Sam Graves, "Graves Questions Treasury Secretary Timothy Geithner on Access to Capital for Small Businesses," press release, June 22, 2011, at http://www.smallbusiness.house.gov/News/DocumentSingle.aspx?DocumentID=248058; and U.S. Congress, House Committee on Small Business, *The State of Small Business Access to Capital and Credit: The View From Secretary Geithner*, 112th Cong., 1st sess., June 22, 2011, Small Business Committee Document No. 112-023 (Washington: GPO, 2011), pp. 3, 9-11, 22, 25. Also see U.S. Government Accountability Office, *Additional Actions Needed to Improve Transparency and Accountability*, GAO-12-183, December 14, 2011, at http://www.gao.gov/products/GAO-12-183.

[55] Treasury and the federal banking agencies ultimately agreed that the banking agencies "would advise Treasury only on the financial viability of applicants and their capacity to increase small business lending, and that they would not make investment recommendations as they had for TARP. It was agreed that an applicant would be considered "viable" if it was (1) adequately capitalized; (2) not expected to become undercapitalized; and (3) not expected to be placed into conservatorship or receivership. Further, the [agencies'] validation of viability of an applicant would reflect only currently available supervisory information and rating assessments at the time the validation was made and would not predict Treasury's loss from making an investment in the institution." See U.S. Department of the Treasury, Office of the Inspector General. *Small Business Lending Fund: Investment Decision Process for the Small Business Lending* (continued...)

financial institutions established as C corporations, Subchapter S corporations, mutual lending institutions, and Community Development Financial Institutions (CDFIs).

A *C corporation* is a legal entity established under state law and includes shareholders, directors, and officers. The profit of a C corporation is taxed to the corporation when earned and then is taxed to the shareholders when distributed as dividends.[56] The majority of insured depository institutions, bank holding companies, and savings and loan holding companies are C corporations.[57] A *Subchapter S corporation* refers to a section of the Internal Revenue Code (IRC) that allows a corporation to pass corporate income, losses, deductions, and credits through to its shareholders for federal tax purposes. Shareholders of S corporations report the flow-through of income and losses on their personal tax returns and are assessed tax at their individual income tax rates. This allows S corporations to avoid double taxation on the corporate income.[58] *Mutual lending institutions*, which include many thrifts and savings and loans associations, are owned by their depositors or policyholders. They have no stockholders. *CDFIs* are financial entities certified by the CDFI Fund in the U.S. Department of the Treasury and provide capital and financial services to underserved communities.

The establishment of separate regulations for each of these different types of financial institutions was largely related to issues involving whether the SBLF's financings would be counted by banking regulatory agencies as Tier 1 capital (core capital that is relatively liquid, such as common shareholders' equity, disclosed reserves, most retained earnings, and perpetual noncumulative preferred stocks) or as Tier 2 capital (supplementary capital that consists mainly of undisclosed reserves, revaluation reserves, general provisions, hybrid instruments, and subordinated term debt).[59]

The treatment of the SBLF's financings was important given that banks must maintain a minimum total risk-based capital ratio of 8% (the ratio measures bank capital against assets, with asset values risk-weighted, or adjusted on a scale of riskiness) to be considered adequately capitalized by federal banking regulators. In addition, banks must maintain a minimum Tier 1 risk-based ratio to assets, typically 3% for banking institutions with the highest financial ratings and 4% for others.[60]

(...continued)

Fund, May 13, 2011, p. 8, at http://www.treasury.gov/about/organizational-structure/ig/Documents/SBLF%20Report%20(OIG-SBLF-11-001).pdf.

[56] Internal Revenue Service, "Corporations," at http://www.irs.gov/businesses/small/article/0,,id=98240,00.html.

[57] U.S. Department of the Treasury, Office of the Inspector General. *Small Business Lending Fund: Investment Decision Process for the Small Business Lending Fund*, May 13, 2011, p. 7, at http://www.treasury.gov/about/organizational-structure/ig/Documents/SBLF%20Report%20(OIG-SBLF-11-001).pdf.

[58] Internal Revenue Service, "S Corporations," at http://www.irs.gov/businesses/small/article/0,,id=98263,00.html.

[59] 12 C.F.R. §325.2: "Tier 1 capital or core capital means the sum of common stockholders' equity, noncumulative perpetual preferred stock (including any related surplus), and minority interests in consolidated subsidiaries, minus all intangible assets (other than mortgage servicing assets, nonmortgage servicing assets, and purchased credit card relationships eligible for inclusion in core capital pursuant to §325.5(f)), minus credit-enhancing interest-only strips that are not eligible for inclusion in core capital minus deferred tax assets in excess of the limit set forth in §325.5(g), minus identified losses (to the extent that Tier 1 capital would have been reduced if the appropriate accounting entries to reflect the identified losses had been recorded on the insured depository institution's books), and minus investments in financial subsidiaries subject to 12 CFR part 362, subpart E, and minus the amount of the total adjusted carrying value of nonfinancial equity investments that is subject to a deduction from Tier 1 capital as set forth in section II.B.(6) of appendix A to this part."

[60] For further information and analysis of federal banking regulations, see CRS Report R40249, *Who Regulates Whom?*
(continued...)

According to Treasury officials, under Internal Revenue Service (IRS) rules, S corporations can have only a single class of stock (common shares). Consequently, these institutions cannot issue preferred stock to Treasury. As a result, Treasury had to consider purchasing subordinated debt from these institutions, which the banking regulatory agencies would likely designate as Tier 2 capital.[61] Treasury officials believed that providing Tier 2 capital would probably result in fewer S corporation participants. Additionally, because mutual institutions do not issue stock, Treasury officials were unable to receive preferred stock as consideration for an investment in this type of institution. Therefore, Treasury had to consider purchasing subordinated debt from these institutions as well.[62]

Treasury completed its regulations for C corporation banks first. For C corporations, SBLF funds will be treated as Tier I capital and the Treasury will purchase senior perpetual noncumulative preferred stock (or an equivalent). The stock will pay a quarterly dividend on the first day of each quarter after closing of the SBLF capital program funding. Tier 1 capital is the core measure of a bank's financial strength from a regulator's point of view. It is composed of core capital, which consists primarily of common stock and disclosed reserves (or retained earnings) but may also include nonredeemable, noncumulative preferred stock. In contrast, S corporations and mutual lending institutions will receive unsecured subordinated debentures from the Treasury, which will be considered Tier 2 capital for regulatory capital requirements.[63]

The application deadline for C corporation banks was May 16, 2011. The application deadline for Subchapter S corporations and mutual lending institutions was June 6, 2011, and the application deadline for CDFIs was June 22, 2011. A total of 926 institutions applied for $11.8 billion in SBLF funding.[64]

Treasury approved more than $4.0 billion in SBLF financing to 332 lending institutions ($3.9 billion to 281 community banks and $104 million to 51 CDFIs).[65] SBLF recipients have offices located in 47 states and the District of Columbia. The average financing was $12.1 million, ranging from $42,000 to $141.0 million.[66]

(...continued)

An Overview of U.S. Financial Supervision, by Edward V. Murphy.

61 U.S. Department of the Treasury, Office of the Inspector General. *Small Business Lending Fund: Investment Decision Process for the Small Business Lending Fund*, May 13, 2011, p. 7, at http://www.treasury.gov/about/organizational-structure/ig/Documents/SBLF%20Report%20(OIG-SBLF-11-001).pdf.

62 Ibid.

63 12 C.F.R. Appendix A to Part 3 - Risk-Based Capital Guidelines: "The following elements comprise a national bank's Tier 2 capital: (1) Allowance for loan and lease losses, up to a maximum of 1.25% of risk-weighted assets, 3 subject to the transition rules in section 4(a)(2) of this appendix A; 3 The amount of the allowance for loan and lease losses that may be included in capital is based on a percentage of risk-weighted assets."

64 U.S. Department of the Treasury, "Small Business Lending Fund Cost Report, Report to Congress submitted pursuant to Section 4106(2) of the Small Business Jobs Act of 2010," July 19, 2011, p. 1, at http://www.treasury.gov/resource-center/sb-programs/DocumentsSBLFTransactions/SBLF%204106(2)%20Cost%20Report.pdf.

65 U.S. Department of the Treasury, "SBLF Investments as of September 27, 2011," at http://www.treasury.gov/resource-center/sb-programs/DocumentsSBLFTransactions/SBLF_Bi-Weekly_Transactions_Report_THRU_09272011.pdf.

66 Ibid.

Of the 332 lending institutions which received financing, 137 institutions had participated in TARP's Community Development Capital Initiative or its Capital Purchase Program. These institutions received nearly $2.7 billion in SBLF financing (66.8% of the total).[67]

Small Business Lending Progress Reports

Treasury is required to publish monthly reports describing all transactions made under the SBLF program during the reporting period. It is also required to publish a semiannual report (each March and September) providing all projected costs and liabilities, operating expenses, and transactions made by the SBLF, including a list of all participating institutions and the amounts each institution has received under the program. In addition, Treasury must publish a quarterly report describing how participating institutions have used the funds they have received under the program.[68]

Institutions participating in the SBLF are required to submit an initial supplemental report to Treasury no later than five business days before closing. The report provides information from the institution's FDIC call reports or, for holding companies, from their subsidiaries' FDIC call reports, that Treasury uses to establish an initial baseline for measuring the SBLF participants' progress in making loans to small businesses.[69]

The initial baseline small business lending amount is the average amount of qualified small business lending that was outstanding for the four full quarters ending on June 30, 2010.[70] This initial baseline amount is derived by first adding the outstanding amount of lending reported for all 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. Then, the outstanding amount of lending for large loans (defined as any loan or group of loans greater than $10 million), loans to large businesses (defined as businesses with annual revenues greater than $50 million), and the portion of any loans guaranteed by the U.S. government or for which the risk is assumed by a third party is subtracted from that amount. The lending institution then adds back any cumulative charge-offs with respect to such loans since July 1, 2010. This last adjustment is done to prevent lending institutions from being penalized for appropriately charging off loans.[71]

The initial small business lending baseline for all SBLF participants, as of June 30, 2014, was $33.0 billion ($32.2 billion for banks and $794.5 million for CDFIs).[72] Because bank and CDFI baseline lending amounts are adjusted to take into account any gains in qualified small business lending during the four baseline quarters resulting from mergers, acquisitions, and loan purchases, the participants' baselines are expected to vary somewhat over time. For example, the initial small business lending baseline for all SBLF participants, as of March 31, 2011, was

[67] Ibid.

[68] P.L. 111-240, the Small Business Jobs Act of 2010, §4106. Reports.

[69] U.S. Department of the Treasury, "SBLF: Getting Started Guide," June 27, 2011, p. 13, at http://www.treasury.gov/resource-center/sb-programs/Documents/SBLF%20Getting%20Started%20Guide.pdf.

[70] Ibid.

[71] Ibid., p. 15.

[72] U.S. Department of the Treasury, "Report on SBLF Participants' Small Business Lending Growth, October 2014," p. 3, at http://www.treasury.gov/resource-center/sb-programs/DocumentsSBLFTransactions/LGR%20October%202014%20FINAL%2010-8-14.pdf .

$35.52 billion ($34.75 billion for banks and $770.48 million for CDFIs).[73] This adjustment is designed to ensure that future dividend rate reductions provided to any SBLF participant correspond to additional lending to small businesses and not to the acquisition of existing loans.[74]

SBLF institutions are also required to submit quarterly supplemental reports, due in the calendar quarter following submission of the initial supplemental report and in each of the next nine quarters, to determine their dividend rate for the next quarter.[75]

Using information contained in the quarterly supplemental reports, Treasury announced in its October 2014 quarterly report on *SBLF Participants' Small Business Lending Growth* that, as of June 30, 2014, "institutions participating in SBLF have made important progress in increasing their small business lending, helping to support small businesses and local economies across the nation":

- In total, current SBLF participants have increased their small business lending by $13.5 billion over a $33.0 billion baseline, which was a $1.1 billion increase over the prior quarter.
- The total increase in small business lending reported by both current and former SBLF participants amounted to $13.8 billion.[76]
- Increases in small business lending are widespread across SBLF participants, with 94% of participants having increased their small business lending over baseline levels.
- Most participants report that their small business lending increases have been substantial, with 92% increasing small business lending by 10% or more.[77]

Treasury also provided information on changes in business lending by the 241 SBLF community banks that continue to participate in the program compared a peer group of 442 community banks that were selected to match the size, geography, and financial condition of SBLF banks and a comparison group of 5,849 similarly sized community banks. Treasury announced that, as of June 30, 2014:

- SBLF banks had increased business loans outstanding by a median of 64.2% over baseline levels, versus a 19.1% median increase for the representative peer group and a 12.7% median increase for the broader comparison group;

[73] U.S. Department of the Treasury, "SBLF Use of Funds Report: Third Quarter 2011 (excel file)," October 26, 2011, at http://www.treasury.gov/resource-center/sb-programs/Pages/sblf_transactions.aspx.

[74] U.S. Department of the Treasury, "SBLF Quarterly 4106(3) Report – 4Q 2011," at http://www.treasury.gov/resource-center/sb-programs/DocumentsSBLFTransactions/Use%20of%20Funds%204016(3)%20Report%20-%2001-09-12.pdf.

[75] U.S. Department of the Treasury, "SBLF: Getting Started Guide," June 27, 2011, p. 13, at http://www.treasury.gov/resource-center/sb-programs/Documents/SBLF%20Getting%20Started%20Guide.pdf.

[76] As of June 30, 2014, 45 institutions with aggregate investments of $681.4 million had fully redeemed their SBLF securities and exited the program.

[77] U.S. Department of the Treasury, "Report on SBLF Participants' Small Business Lending Growth, October 2014," p. 1, at http://www.treasury.gov/resource-center/sb-programs/DocumentsSBLFTransactions/LGR%20October%202014%20FINAL%2010-8-14.pdf .

- SBLF banks had increased business lending by substantially greater amounts across median measures of size, geography, loan type, and financial condition versus peer and comparison groups; and
- SBLF banks that refinanced CPP [TARP's Capital Purchase Program] funding had increased business lending by a median of 57.6% since their initial receipt of CPP funding from Treasury versus a 23.3% increase for the peer group and a 18.1% increase for the comparison group over the same period.[78]

Treasury officials have praised the SBLF's performance. For example, on October 9, 2012, Deputy Secretary of the Treasury Neal Wolin announced that the SBLF quarterly use of funds report released that day "is further indication that the Administration's Small Business Lending Fund is continuing to help create an environment in which entrepreneurial small businesses can succeed and excel."[79] He added that "banks in the SBLF program continue to show large increases in the lending available for small businesses to grow, create jobs, and support families in communities across the country."[80]

Some financial commentators have expressed a somewhat less sanguine view of the program's performance. For example, one commentator noted, after the release of the quarterly use of funds report in January 2012, that although the report of increased small business lending was positive news "it is difficult to isolate the proportion of new lending that would have occurred anyway" due to improvements in the economy.[81] Another commentator noted that the data may have been skewed by SBLF participants who were entering the small business lending market for the first time, making the increases appear larger and more significant than they actually are; yet another noted that the reported growth in small business lending occurred over six quarters (since June 30, 2010) and that the results, although positive, are "not as impressive as it may seem."[82] A commentator argued in September 2012 that "if the SBLF ends up being a success story, it will have been on a far smaller scale than either Obama or Congress had originally expected. What's more, it's become clear that even boatloads of financing won't change the fact that demand for the loans themselves has also fallen off, as small businesses themselves are reluctant to expand in a stagnant economy."[83]

In addition, on August 29, 2013, Treasury's Office of Inspector General (OIG) released an audit of Treasury's reporting of small business lending gains relative to small business lending levels prior to the lenders' participation in the program. The OIG found that "small business lending gains reported by Treasury are significantly overstated and cannot be linked directly to SBLF funding."[84] Specifically, the OIG noted that "substantial amounts [$3.4 billion of the then

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[78] Ibid.

[79] U.S. Department of the Treasury, "Treasury Announces $6.7 Billion Increase in Small Business Lending at Banks Receiving Capital through the Small Business Lending Fund (SBLF)," October 9, 2012, at http://www.treasury.gov/press-center/press-releases/Pages/tg1731.aspx.

[80] Ibid.

[81] Harry Terris, "Former TARP Banks Lag Peers in SBLF Lending," *American Banker*, vol. 177, no. 16, January 25, 2012.

[82] Kate Davidson, "Was the SBLF Program a Success?" *American Banker,* vol. 177, no. 8, January 12, 2012.

[83] Suzy Khimm, "Has Obama Really Helped Small Business?" *The Washington Post*, September 11, 2012, at http://www.washingtonpost.com/blogs/ezra-klein/wp/2012/09/11/has-obama-really-helped-small-businesses/.

[84] U.S. Department of the Treasury, Office of the Inspector General, *Small Business Lending Fund: Reported SBLF Program Accomplishments Are Misleading Without Additional Reporting*, August 29, 2013, p. 8, at http://www.treasury.gov/about/organizational-structure/ig/Audit%20Reports%20and%20Testimonies/OIG-SBLF-13-(continued...)

reported $8.9 billion] of the reported gains occurred prior to participants receiving SBLF funding." As the OIG explained,

> the lending gains reported [by Treasury] were measured against the same baseline period that the Small Business Jobs Act of 2010 (the Act) instructs Treasury to use for setting dividend rates for repayment of the SBLF capital, which is the four calendar quarters [which] ended [on] June 30, 2010. However, measuring program performance against a baseline with a midpoint seven quarters prior to when most participants received funding inflates program accomplishments and is not responsive to provisions in the Act that direct Treasury to report on participant use of the SBLF funds received.[85]

The OIG also argued that the reported lending gains cannot be directly linked to the SBLF capital that Treasury invested in the financial institutions because the lending gains reported "represent all small business lending gains that institutions participating in the SBLF achieved, regardless of how the loans were funded."[86] In addition, the OIG noted, among other findings, that "a relatively small number (35 or 11%) of SBLF participants accounted for half of small business lending increases between the baseline figure and December 31, 2012."[87]

Proposed Legislation

During the 112th Congress, several bills were introduced to change the SBLF. None of the bills were enacted. For example, then-Senator Snowe introduced S. 681, the Greater Accountability in the Lending Fund Act of 2011, on March 30, 2011. Senator Snowe argued that

> While I would prefer to terminate this fund altogether, it is unlikely based on the current political environment, which is why we must work to protect taxpayers from some of its most egregious provisions. My goal with this legislation is to ensure that only healthy banks have access to taxpayer money, that they are required to repay loans within a reasonable period of time, and that small businesses find the affordable credit they need.[88]

The bill would have, among other things,

- required recipients to repay SBLF distributions within 10 years of the receipt of the investment;[89]
- terminated the program no later than 15 years after the date of the bill's enactment;[90]

(...continued)

012%20fix%209%2010%2013.pdf.

[85] Ibid., pp. 3, 9-11.

[86] Ibid., pp. 3, 11-13.

[87] Ibid., p. 11.

[88] U.S. Senator Olympia Snowe, "Snowe Calls for Comprehensive Fixes to Small Business Lending Fund," press release, March 30, 2011, at http://snowe.senate.gov/public/index.cfm/pressreleases?ContentRecord_id=b1507369-8193-44ff-94ae-ceb94d5debe8&ContentType_id=ae7a6475-a01f-4da5-aa94-0a98973de620&Group_id=2643ccf9-0d03-4d09-9082-3807031cb84a&MonthDisplay=3&YearDisplay=2011.

[89] Current law provides the Treasury Secretary the discretion to extend the repayment period beyond 10 years. P.L. 111-240, the Small Business Jobs Act of 2010, §4103(d)(5)(h); 12 U.S.C. §4741.

[90] Current law does not include a termination date for the program, other than terminating the authority to make capital (continued...)

- prohibited the Secretary of the Treasury from making capital investments under the program if the FDIC is appointed receiver of 5% or more of the institutions receiving an investment under the program;
- prohibited participation by any institution that received an investment under TARP (effective on the date of the bill's enactment);
- removed provisions allowing the Secretary of Treasury to make a capital investment in institutions that would otherwise not be recommended to receive the investment based on the institution's financial condition, but are able to provide a matching investment from private, nongovernmental investors;
- required the approval of appropriate financial regulators when determining whether an institution should receive a capital investment;[91] and
- revised the benchmark against which changes in the amount of small business lending is measured from the four full quarters immediately preceding the date of enactment to calendar year 2007.[92]

Representative Patrick McHenry introduced H.R. 1387, the Small Business Lending Fund Accountability Act of 2011, on May 2, 2011. It would have provided the Special Inspector General for TARP responsibility for providing oversight over the SBLF.

Senator Tom Coburn proposed S.Amdt. 279 to S. 493, the Small Business Innovation Research, Small Business Technology Transfer Reauthorization Act of 2011, on March 31, 2011. It would have prevented TARP recipients from using funds received in any form under any other federal assistance program, including the SBLF program.

Representative Cedric Richmond introduced H.R. 2807, the Small Business Leg-Up Act of 2011, on August 5, 2011. It would have transferred any unobligated and repaid funds from the SBLF to the Community Development Financial Institutions Fund beginning on the date when the Secretary of the Treasury's authority to make capital investments in eligible institutions expired (on September 27, 2011). The bill's stated intent was "to increase the availability of credit for small businesses."[93]

Representative John Carney introduced H.R. 3147, the Small Business Lending Extension Act, on October 21, 2011. It would have extended the Treasury Department's investment authority from one year following enactment to two years and required the Treasury Secretary to provide any

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investments in eligible institutions one year after the date of enactment. P.L. 111-240, the Small Business Jobs Act of 2010, §4109. Termination and Continuation of Authorities.

[91] Current law requires the Treasury Secretary to consult with appropriate financial regulators to determine if the eligible institution may receive a capital investment under the program. P.L. 111-240, the Small Business Jobs Act of 2010, §4103(d); 12 U.S.C. §4741.

[92] Senator Snowe indicated that this change "would address concerns that the existing benchmark may be too low, by historical standards, and that an adjustment could result in additional small business lending. See U.S. Senator Olympia Snowe, "Snowe Calls for Comprehensive Fixes to Small Business Lending Fund," Washington DC, March 30, 2011, at http://snowe.senate.gov/public/index.cfm/pressreleases?ContentRecord_id=b1507369-8193-44ff-94ae-ceb94d5debe8&ContentType_id=ae7a6475-a01f-4da5-aa94-0a98973de620&Group_id=2643ccf9-0d03-4d09-9082-3807031cb84a&MonthDisplay=3&YearDisplay=2011.

[93] H.R. 2807, the Small Business Leg-Up Act of 2011.

institution not selected for participation in the program the reason for the rejection, ensure that the rejection reason remains confidential, and establish an appeal process that provides the institution an opportunity to contest the reason provided for the rejection of its application.

During the 113th Congress, Representative Cedric Richmond introduced H.R. 2474, the Community Lending and Small Business Jobs Act of 2013. It would, among other provisions, transfer any unobligated and repaid funds from the SBLF to the Community Development Financial Institutions Fund.[94]

Concluding Observations

The SBLF was enacted as part of a larger effort to enhance the supply of capital to small businesses. Advocates argued that the SBLF would help to address the decline in small business lending and create jobs. Opponents were not convinced that it would enhance small business lending and worried about the program's potential cost to the federal treasury and its similarities to TARP.

Participating institutions are reporting they have increased their small business lending. However, as has been discussed, questions have been raised concerning the validity of these reported amounts. Specifically, as Treasury's OIG argued in its August 2013 audit, more than one-third of the reported lending gains occurred prior to September 30, 2011, the quarter in which most SBLF participants received their SBLF funds; the reported small business lending gains reflect all of the small business lending gains that the participants achieved, regardless of how the loans were funded; and previous OIG audits "have shown that a large number of participants misreport their small business lending activity."[95] In those previous audits, "50% or more of the institutions reviewed submitted erroneous lending data to Treasury, either overstating or understating their small business lending gains."[96]

[94] H.R. 2474 was introduced on June 20, 2013, and referred to the Committee on Financial Services, and, in addition, to the Committees on Small Business, and Education and the Workforce, for a period to be subsequently determined by the Speaker, in each case for consideration of such provisions as fall within the jurisdiction of the committee concerned.

[95] U.S. Department of the Treasury, Office of the Inspector General, *Small Business Lending Fund: Reported SBLF Program Accomplishments Are Misleading Without Additional Reporting*, August 29, 2013, pp. 3, 4, at http://www.treasury.gov/about/organizational-structure/ig/Audit%20Reports%20and%20Testimonies/OIG-SBLF-13-012%20fix%209%2010%2013.pdf.

[96] Ibid., p. 4. Under the Small Business Jobs Act, the Department of the Treasury's Inspector General is required to conduct audits and investigations of the SBLF and to report its findings to Congress and the Secretary of the Treasury no less than two times a year. To date, Treasury's Inspector General has released 10 SBLF reports (one informal and nine formal). These reports examined and made recommendations for improving Treasury's early investment decision process for evaluating SBLF applicants (informal audit, May 13, 2011); Treasury's SBLF cost and liabilities projections (December 22, 2011); Treasury's investment decisions concerning early-entry SBLF participants (February 17, 2012); Treasury's investment decisions concerning later-entry SBLF participants (July 3, 2012); the accuracy of SBLF participants' reports of their baseline lending amounts (August 21, 2012); the accuracy of third quarter 2012 dividend rate adjustments (January 29, 2013); the accuracy of fourth quarter 2012 dividend rate adjustments (August 9, 2013); the accuracy of reported small business lending gains (August 29,2013); the accuracy of first quarter 2013 dividend rate adjustments (September 27, 2013); and use of capital, plans for repaying SBLF funds, and recipient satisfaction with Treasury's administration of the program (March 27, 2014). To view the OIG's audits see U.S. Department of the Treasury, Office of the Inspector General, "Office of Small Business Lending Fund (SBLF) Oversight," at http://www.treasury.gov/about/organizational-structure/ig/Pages/Office-of-Small-Business-Lending-Fund-Program-Oversight.aspx. In addition, the Government Accountability Office (GAO) was required to audit the (continued...)

In addition to questions related to the validity of the reported small business lending gains, any analysis of the program's influence on small business lending is likely to be more suggestive than definitive because differentiating the SBLF's effect on small business lending from other factors, such as changes in the lender's local economy, is methodologically challenging, especially given the relatively small amount of financing involved relative to the national market for small business loans. The SBLF's $4.0 billion in financing represents less than 0.7% of outstanding small business loans (as defined by the FDIC).[97]

It is too early to fully address opponents' concerns about the program's potential cost. In December 2010, before accepting any applicants, Treasury initially estimated the SBLF could cost taxpayers up to $1.26 billion (excluding administrative costs that were initially estimated at about $26 million annually but were $18.7 million in FY2013).[98] It based that estimate on an expectation that about $17 billion in SBLF financings would be disbursed. In October 2011, Treasury estimated the program's costs based on actual participant data. It estimated that the SBLF will generate a savings of $80 million (excluding administrative costs), with the savings coming primarily from a lower-than-expected financing level and, to a lesser extent, improvements in projected default rates "due to higher participant quality than expected" and lower market interest rates.[99] Treasury issues a semiannual report on SBLF costs. In its latest semiannual cost report, released on June 6, 2014, Treasury estimated that the SBLF will "generate a lifetime positive return of $25 million," excluding administrative costs.[100]

One issue that has arisen relative to the program's projected cost is the noncumulative treatment of dividends. Treasury's OIG reported in May 2011 that

> Under the terms set by legislation, dividend payments are non-cumulative, meaning that institutions are under no obligation to make dividend payments as scheduled or to pay off previously missed payments before exiting the program. This dividend treatment differs from the TARP programs, in which many dividend payments were cumulative. This change in dividend treatment was driven by changes in capital requirements mandated by the Collins Amendment to the Dodd-Frank Act.
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> The amendment equalizes the consolidated capital requirements for Tier 1 capital of bank holding companies by requiring that, at a minimum, regulators apply the same capital and risk standards for FDIC-insured banks to bank holding companies. Under TARP, the FRB

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program annually. P.L. 113-188, the Government Reports Elimination Act of 2014, repealed this requirement.

[97] As of June 30, 2014, the FDIC reports that small business loans (defined by the FDIC as commercial and industrial loans of $1 million or less) for non-agricultural purposes was $589.7 billion ($4 billion/$589.7 billion = 0.68%). See Federal Deposit Insurance Corporation, "Statistics on Depository Institutions," at http://www2.fdic.gov/SDI/main.asp.

[98] Program administrative costs (e.g., monitoring the performance and compliance of participants, reporting on the program's performance and costs, and managing the securities purchased through the SBLF program) must be excluded from subsidy cost estimates in accordance with guidelines in the Federal Credit Reform Act of 1990. See OMB Circular A-11, §185.2. Also, see U.S. Department of the Treasury, "Cost report," June 6, 2014, p. 4 at http://www.treasury.gov/resource-center/sb-programs/DocumentsSBLFTransactions/4106(2)%20Cost%20Report%20(Semiannual).pdf.

[99] U.S. Department of the Treasury, Office of the Inspector General, *Small Business Lending Fund: Treasury Should Consider Concerns Regarding Participants Management and Historical Retained Earnings When Estimating the Cost of the SBLF Program*, December 22, 2011, pp. 1-3, at http://www.treasury.gov/about/organizational-structure/ig/Agency%20Documents/Cost%20of%20SBLF%20Program%20-%20Final%20Report%20for%20Internet.pdf.

[100] U.S. Department of the Treasury, "Cost report," June 6, 2014, p. 4 at http://www.treasury.gov/resource-center/sb-programs/DocumentsSBLFTransactions/4106(2)%20Cost%20Report%20(Semiannual).pdf.

> [Federal Reserve Board] and FDIC treated capital differently at the holding company and depository institution levels. The FRB treated cumulative securities issued by holding companies as Tier 1 capital, while FDIC treated non-cumulative securities issued by depository institutions as Tier 1 capital. In order to comply with the Dodd-Frank Act requirement that securities purchased from holding companies receive the same capital treatment as those purchased from depository institutions, Treasury made the dividends under SBLF non-cumulative.
>
> Additionally, given that Tier 1 capital must be perpetual and cannot have a mandatory redemption date, the 10-year repayment period in the Small Business Jobs Act cannot be enforced.[101]

Treasury addressed this issue by placing the following additional requirements and restrictions on participants who miss dividend payments:

- the participant's CEO [Chief Executive Office] and CFO [Chief Financial Officer] must provide written notice regarding the rationale of the board of directors (BOD) for not declaring a dividend;
- no repurchases may be affected and no dividends may be declared on any securities for the applicable quarter and the following three quarters;
- after four missed payments (consecutive or not), the issuer's BOD must certify in writing that the issuer used best efforts to declare and pay dividends appropriately;
- after five missed payments (consecutive or not), Treasury may appoint a representative to serve as an observer on the issuer's BOD; and
- after six missed payments (consecutive or not), Treasury may elect two directors to the issuer's BOD if the liquidation preference is $25 million or more.[102]

Treasury's OIG agreed that Treasury's equity investment policy is consistent with the legislation and that "it has reasonably structured the program to incentivize payment of dividends."[103] However, it recommended that "Congress consider whether an amendment to the Small Business Jobs Act and/or waiver from the Collins Amendment to the Dodd-Frank Act is needed to make the repayment of dividends a requirement for exiting the program."[104]

In conclusion, congressional oversight of the SBLF is currently focused on the program's potential long-term costs and effects on small business lending. Underlying those concerns are fundamental disagreements regarding the best way to assist small businesses. Some advocate the provision of additional federal resources to assist small businesses in acquiring capital necessary to start, continue, or expand operations and create jobs. Others worry about the long-term adverse economic effects of spending programs that increase the federal deficit. They advocate business

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[101] U.S. Department of the Treasury, Office of the Inspector General, *Small Business Lending Fund: Investment Decision Process for the Small Business Lending Fund*, May 13, 2011, p. 19, at http://www.treasury.gov/about/organizational-structure/ig/Documents/SBLF%20Report%20(OIG-SBLF-11-001).pdf.

[102] Ibid., pp. 19, 20.

[103] Ibid., p. 20.

[104] Ibid., p. 25.

tax reduction, reform of financial credit market regulation, and federal fiscal restraint as the best means to assist small businesses and create jobs.

Appendix. The SBLF's Legislative History

The SBLF's Legislative Origin

On March 16, 2009, President Obama announced the first SBLF-like proposal. Under that proposal, the Department of the Treasury would have used TARP funds to purchase up to $15 billion of SBA-guaranteed loans.[105] The purchases were intended to "immediately unfreeze the secondary market for SBA loans and increase the liquidity of community banks."[106] The plan was dropped after it met resistance from lenders. Some lenders objected to TARP's requirement that participating lenders comply with executive compensation limits and issue warrants to the federal government. Smaller, community banks objected to the program's paperwork requirements, such as the provision of a small-business lending plan and quarterly reports.[107]

In his January 2010 State of the Union address, President Obama proposed the creation of a $30 billion SBLF to enhance access to credit for small businesses:

> When you talk to small business owners in places like Allentown, Pennsylvania, or Elyria, Ohio, you find out that even though banks on Wall Street are lending again, they're mostly lending to bigger companies. Financing remains difficult for small business owners across the country, even those that are making a profit.
>
> Tonight, I'm proposing that we take $30 billion of the money Wall Street banks have repaid and use it to help community banks give small businesses the credit they need to stay afloat.[108]

In response to the opposition community lenders had expressed concerning TARP's restrictions in 2009, the Obama Administration proposed that Congress approve legislation authorizing the transfer of up to $30 billion in TARP spending authority to the SBLF and statutorily establish the new program as distinct and independent from TARP and its restrictions.[109] The Administration's legislative proposal was finalized and sent to Congress on May 7, 2010.[110] Representative Barney

[105] P.L. 110-343, the Emergency Economic Stabilization Act of 2008, was designed to enhance the supply of loans to businesses of all sizes. The act authorized the Troubled Asset Relief Program (TARP) to "restore liquidity and stability to the financial system of the United States" by purchasing or insuring up to $700 billion in troubled assets from banks and other financial institutions. TARP's purchase authority was later reduced from $700 billion to $475 billion by P.L. 111-203, the Dodd-Frank Wall Street Reform and Consumer Protection Act. The Department of the Treasury has disbursed $389 billion in TARP funds, including $337 million to purchase SBA 7(a) loan guaranty program securities. The authority to make new TARP commitments expired on October 3, 2010. U.S. Department of the Treasury, Troubled Assets Relief Program Monthly 105(a) Report—November 2010, December 10, 2010, pp. 2-4, at http://www.treasury.gov/initiatives/financial-stability/briefing-room/reports/105/Documents105/November%20105(a)%20FINAL.pdf. For further analysis, see CRS Report R41427, *Troubled Asset Relief Program (TARP): Implementation and Status*, by Baird Webel.

[106] The White House, "Remarks by the President to Small Business Owners, Community Leaders, and Members of Congress," March 16, 2009, at http://www.whitehouse.gov/the_press_office/Remarks-by-the-President-to-small-business-owners/.

[107] Emily Flitter, "Fix for SBA Snagged by Tarp's Exec Comp Limits," *American Banker*, vol. 174, no. 61 (March 31, 2009), p. 1.

[108] The White House, "Remarks by the President in State of the Union Address," January 27, 2010, at http://www.whitehouse.gov/the-press-office/remarks-president-state-union-address.

[109] The White House, "President Obama Outlines New Small Business Lending Fund," February 2, 2010, at http://www.whitehouse.gov/the-press-office/president-obama-outlines-new-small-business-lending-fund.

[110] The White House, "Remarks by the President on the Monthly Job Numbers," May 7, 2010, at
(continued...)

Frank, then-chair of the House Committee on Financial Services, introduced H.R. 5297, the Small Business Lending Fund Act of 2010, on May 13, 2010.

The House Committee on Financial Services held a hearing on H.R. 5297 on May 18, 2010, and passed the bill, as amended to include a State Small Business Credit Initiative, the following day. The House passed the bill, as amended to include a Small Business Early-Stage Investment Program, a Small Business Borrower Assistance Program, and some small business tax reduction provisions, on June 17, 2010.

The House-Passed Version of the SBLF

Title I of the House-passed version of H.R. 5297 authorized the Secretary of the Treasury to establish a $30 billion SBLF "to address the ongoing effects of the financial crisis on small businesses by providing temporary authority to the Secretary of the Treasury to make capital investments in eligible institutions" with total assets equal to or less than $1 billion or $10 billion (as of the end of the fourth quarter of calendar year 2009) "in order to increase the availability of credit for small businesses."[111] The authority to make capital investments in eligible institutions was limited to one year after enactment.

Eligible financial institutions having total assets equal to or less than $1 billion as of the end of the fourth quarter of calendar year 2009 could apply to receive a capital investment from the SBLF in an amount not exceeding 5% of risk-weighted assets, as reported in the FDIC call report immediately preceding the date of application. During the fourth quarter of 2009, 7,340 FDIC-insured lending institutions reported having assets amounting to less than $1 billion.[112]

Eligible financial institutions having total assets equal to or less than $10 billion as of the end of the fourth quarter of calendar year 2009 could apply to receive a capital investment from the fund in an amount not exceeding 3% of risk-weighted assets, as reported in the FDIC call report immediately preceding the date of application. During the fourth quarter of 2009, 565 FDIC-insured lending institutions reported having assets of $1 billion to $10 billion.[113]

Risk-weighted assets are assets such as cash, loans, investments, and other financial institution assets that have different risks associated with them. FDIC regulations (12 C.F.R. §567.6) establish that cash and government bonds have a 0% risk-weighting; residential mortgage loans have a 50% risk-weighting; and other types of assets (such as small business loans) have a higher risk-weighting.[114]

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http://m.whitehouse.gov/the-press-office/remarks-president-monthly-jobs-numbers.

[111] H.R. 5297, the Small Business Jobs and Credit Act of 2010, §101. Small Business Lending Fund Purpose. In 2011, there were 7,513 FDIC-insured lending institutions in the United States. Of that number, 6,846 lending institutions had assets amounting to less than $1 billion (totaling $1.42 trillion), 561 lending institutions had assets of $1 billion to $10 billion (totaling $1.43 trillion), and 106 lending institutions had assets greater than $10 billion (totaling $10.76 trillion). See FDIC, "Quarterly Banking Profile: Second Quarter 2011," at http://www2.fdic.gov/qbp/2011jun/qbp.pdf.

[112] FDIC, "Quarterly Banking Profile: Fourth Quarter 2009," at http://www2.fdic.gov/qbp/2009dec/qbp.pdf.

[113] Ibid. In the fourth quarter of 2009, 107 FDIC-insured lending institutions had assets greater than $10 billion.

[114] For further analysis of risk-weighted assets, see CRS Report R40249, *Who Regulates Whom? An Overview of U.S. Financial Supervision*, by Edward V. Murphy.

Lending institutions on the FDIC problem bank list or institutions that have been removed from the FDIC problem bank list for less than 90 days were ineligible to participate in the program. Lending institutions could refinance securities issued through the Treasury Capital Purchase Program (CPP) and the Community Development Capital Incentive (CDCI) program under TARP, but only if the institution had not missed more than one dividend payment due under those programs.

Participating banks would be charged a dividend rate of 5% per annum initially, with reduced rates available if the bank increased its small business lending. For example, during any calendar quarter in the initial two years of the capital investments under the program, the bank's rate would be lowered if it had increased its small business lending compared to the average small business lending it made in the four previous quarters immediately preceding the enactment of the bill, minus some allowable adjustments. A 2.5% to 5% increase in small business lending would have lowered the rate to 4%, a 5% to 7.5% increase would have lowered the rate to 3%, a 7.5% to 10% increase would have lowered the rate to 2%, and an increase greater than 10% would have lowered the rate to 1%. **Table A-1** shows the dividend rates associated with small business lending increases by financial institutions under H.R. 5297. These rates were subsequently included in the final law.

Table A-1. Small Business Lending Increases and Dividend Rates Under the House-Passed Version of H.R. 5297

Small Business Lending Increase	Dividend Rate
10% or greater	1%
at least 7.5% but less than 10%	2%
at least 5% but less than 7.5%	3%
at least 2.5% but less than 5%	4%
Less than 2.5%	5%
No increase	7%

Source: H.R. 5297, the Small Business Jobs and Credit Act of 2010, Section 103. Small Business Lending Fund.

Notes: The dividend rate would increase to 9% at the end of the five-year period that begins on the date of the capital investment under the program. The Senate-passed version of H.R. 5297, which became the Small Business Jobs Act of 2010, authorizes the same dividend rates.

SBLF applicants were also required to submit a small business lending plan to the appropriate federal banking agency and, for applicants that are state-chartered banks, to the appropriate state banking regulator. The plan was to describe how the applicant's business strategy and operating goals will allow it to address the needs of small businesses in the areas it serves, as well as a plan to provide linguistically and culturally appropriate outreach, where appropriate. The plan was to be treated as confidential supervisory information. The Secretary of the Treasury was required to consult with the appropriate federal banking agency or, in the case of an eligible institution that is a non-depository community development financial institution, the Community Development Financial Institution Fund, before determining if the eligible institution was to participate in the program.[115]

[115] If the appropriate banking agency would not otherwise recommend that the eligible institution receive the capital investment, the Secretary of the Treasury was authorized, in consultation with the appropriate banking agency, to
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The bill specified that the SBLF would be "established as separate and distinct from the Troubled Asset Relief Program established by the Emergency Economic Stabilization Act of 2008. An institution shall not, by virtue of a capital investment under the Small Business Lending Fund Program, be considered a recipient of the Troubled Asset Relief Program."[116]

The bill also directed that all funds received by the Secretary of the Treasury in connection with purchases made by the SBLF, "including interest payments, dividend payments, and proceeds from the sale of any financial instrument, shall be paid into the general fund of the Treasury for reduction of the public debt."[117]

The Senate-Passed Version of the SBLF

Title IV of the Senate-passed version of H.R. 5297, which later became law, authorized the Secretary of the Treasury to establish a $30 billion SBLF to make capital investments in eligible community banks with total assets equal to or less than $1 billion or $10 billion. There were several differences between the Senate-passed version of H.R. 5297's SBLF provisions and the SBLF provisions in the House-passed version of H.R. 5297. Specifically, the

- House-passed version of H.R. 5297 indicated that eligible institutions may be insured depository institutions that are not controlled by a bank holding company or a savings and loan holding company that is also an eligible institution and is not directly or indirectly controlled by any company or other entity that has total consolidated assets of more than $10 billion, bank holding companies, savings and loan holding companies, community development financial institution loan funds, and small business lending companies, all with total assets of $10 billion or less (as of the end of 2009).[118] The Senate-passed version of H.R. 5297 did not provide eligibility to small business lending companies.[119]
- House-passed version of H.R. 5297 defined small business lending "as small business lending as defined by and reported in an eligible institution's quarterly call report, where each loan comprising such lending is made to a small business and is one the following types: (1) commercial and industrial loans; (2) owner-occupied nonfarm, nonresidential real estate loans; (3) loans to finance agricultural production and other loans to farmers; (4) loans secured by farmland; (5) nonowner-occupied commercial real estate loans; and (6) construction, land development and other land loans."[120] The Senate-passed version of H.R. 5297's

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consider allowing the eligible institution to participate in the program if the eligible institution provided matching capital from private, non-governmental sources that is equal to or greater than 100% of the SBLF investment and that matching capital was subordinate to the capital investment from the SBLF.

116 H.R. 5297, the Small Business Lending Fund Act of 2010, §111. Assurances.

117 H.R. 5297, the Small Business Lending Fund Act of 2010, §103. Small Business Lending Fund. Using a cost-based estimate, CBO estimated that the SBLF would result in net outlays of $3.3 billion over 2010-1015, and would reduce outlays by $1.1 billion over the 2010-2020 period. Using an alternative fair-value estimate, CBO estimated that the SBLF would result in net outlays of $6.2 billion over the 2010-2020 period. See CBO , "Cost Estimate: H.R. 5297, Small Business Lending Fund Act of 2010," June 28, 2010, pp. 3, 4, at http://www.cbo.gov/ftpdocs/115xx/doc11595/hr5297_HousePassed.pdf.

118 H.R. 5297, the Small Business Lending Fund Act of 2010, §102. Definitions.

119 P.L. 111-240, the Small Business Jobs Act of 2010, §4102. Definitions.

120 H.R. 5297, the Small Business Lending Fund Act of 2010, §102. Definitions.

definition of small business lending did not include nonowner-occupied commercial real estate or construction, land development and other land loans.[121]

- Senate-passed version of H.R. 5297 had an exclusion provision prohibiting recipient lending institutions from using the funds to issue loans that have an original amount greater than $10 million or that would be made to a business with more than $50 million in revenues.[122] The House-passed version of H.R. 5297 did not contain this provision.
- House-passed version of H.R. 5297 indicated that the incentives received in the form of reduced dividend rates during the first 4.5-year period following the date on which an eligible institution received a capital investment under the program would be contingent on an increase in the number of loans made.[123] If the number of loans made by the institution did not increase by 2.5% for each 2.5% increase of small business lending, then the rate at which dividends and interest would be payable during the following quarter on preferred stock or other financial instruments issued to the Treasury by the eligible institution would be (i) 5%, if this quarter is within the two-year period following the date on which the eligible institution received the capital investment under the program; or (ii) 7%, if the quarter is after the two-year period. The Senate-passed version of H.R. 5297 did not contain this legislative language.
- House-passed version of H.R. 5297 included an alternative computation provision that would have allowed eligible institutions to compute their small business lending amounts for incentive purposes as if the definition of their small business lending amounts did not require that the loans comprising such lending be made to small business.[124] This alternative computation would have been allowed if the eligible institution certified that all lending included by the institution for purposes of computing the increase in lending was made to small businesses. The Senate-passed version of H.R. 5297 did not contain this provision.
- House-passed version of H.R. 5297 indicated that an eligible institution that is a community development loan fund may apply to receive a capital investment from the SBLF in an amount not exceeding 10% of total assets, as reported in the audited financial statements for the fiscal year of the eligible institution that ended in calendar year 2009.[125] The Senate-passed version of H.R. 5297 specifies 5%.[126]
- House-passed version of H.R. 5297 would have required the Secretary of the Treasury, in consultation with the Community Development Financial Institutions Fund, to develop eligibility criteria to determine the financial ability of a Community Development Loan Fund to participate in the program and repay the investment. It provided a list of recommended eligibility criteria that the

[121] P.L. 111-240, the Small Business Jobs Act of 2010, §4102. Definitions.

[122] H.R. 5297, the Small Business Lending Fund Act of 2010, §103. Small Business Lending Fund.

[123] Ibid.

[124] Ibid.

[125] Ibid.

[126] P.L. 111-240, the Small Business Jobs Act of 2010, §4103. Small Business Lending Fund.

Secretary of the Treasury could use for this purpose.[127] The Senate-passed version of H.R. 5297 provided a similar, but mandatory, list of eligibility criteria that must be used for this purpose.[128]

- House-passed version of H.R. 5297 contained a temporary amortization authority provision which would have allowed an eligible institution to amortize any loss or write-down on a quarterly straight-line basis over a period of time, adjusted to reflect the institution's change in the amount of small business lending relative to the baseline.[129] The Senate-passed version of H.R. 5297 did not contain this provision.

The Senate's version of H.R. 5297 was agreed to in the Senate on September 16, 2010, after considerable debate and amendment to remove the Small Business Early-Stage Investment Program and Small Business Borrower Assistance Program, revise the SBLF, and add numerous other provisions to assist small businesses, including additional small business tax reduction provisions.[130] The House agreed to the Senate amendments on September 23, 2010, and President Obama signed the bill, retitled the Small Business Jobs Act of 2010 (P.L. 111-240), into law on September 27, 2010.

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[127] H.R. 5297, the Small Business Lending Fund Act of 2010, §103. Small Business Lending Fund.

[128] P.L. 111-240, the Small Business Jobs Act of 2010, §4103. Small Business Lending Fund.

[129] H.R. 5297, the Small Business Lending Fund Act of 2010, §113. Temporary Amortization Authority.

[130] For additional information and analysis concerning P.L. 111-240, the Small Business Jobs Act of 2010, see CRS Report R40985, *Small Business: Access to Capital and Job Creation*, by Robert Jay Dilger.