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Report to Congressional Committees

December 2011

SMALL BUSINESS LENDING FUND

Additional Actions Needed to Improve Transparency and Accountability

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ACCOUNTABILITY ★ INTEGRITY ★ RELIABILITY

GAO-12-183

GAO
Accountability * Integrity * Reliability
Highlights

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

Why GAO Did This Study

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

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

What GAO Recommends

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

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What GAO Found

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

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

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

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Abbreviations

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

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Congressional Committees

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

To address these concerns, on September 27, 2010, President Obama signed into law the Small Business Jobs Act of 2010.[2] Among other things, this legislation aims to stimulate job growth by establishing the Small Business Lending Fund program (SBLF). The SBLF program is designed to encourage banks and community development loan funds (CDLF) with assets of less than $10 billion to increase their lending to small businesses with up to $50 million in annual revenues.[3] The act authorizes the Treasury Secretary to make up to $30 billion of capital available and offers incentives to increase small business lending.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Background

SBLF Goals, Considerations, and Eligibility Requirements

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

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

SBLF is intended to increase small business lending. For the purposes of the program, the legislation defined qualified small business lending—as defined in an institution's quarterly regulatory filings (call reports)—as one of the following:[10]

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

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

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

SBLF Application Process and Requirements

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

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

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

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

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

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

SBLF Funding and Incentives for Small Business Lending

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

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

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

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

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

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

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

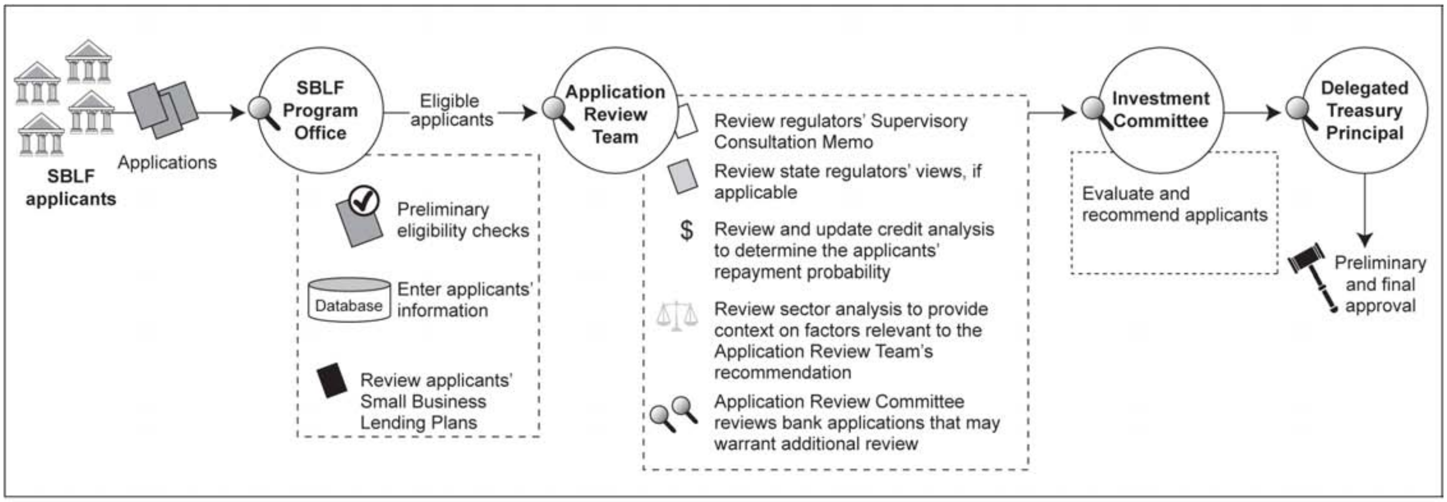
Institutions chosen to participate in SBLF must submit an Initial Supplemental Report to Treasury that calculates the baseline level of small business lending and the initial dividend rate. SBLF institutions must continue submitting Quarterly Supplemental Reports to calculate dividend rates for the next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

Treasury's Application Requirements and Decisions Were Not Always Transparent

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

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

Figure 1: Treasury's Process for Evaluating SBLF Applicants



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

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

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

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

- *Supervisory consultation memo:* As part of the evaluation process, Treasury obtained supervisory consultation from the appropriate federal banking regulators to determine the financial condition and performance of applicant banks. In the memo, the regulators did not recommend whether the applicant should be approved; rather the memo summarized supervisory information (e.g., CAMELS composite ratings and a description of material supervisory issues, if any) about the applicant's financial condition and performance and specifically indicated whether the applicant was viable.[17] "Viable" was defined as adequately capitalized, not expected to become undercapitalized, and not expected to be placed into conservatorship or receivership.[18]

- *Repayment probability:* The Application Review Team also considered an independent credit analysis of applicant's ability to repay SBLF investments while making consistent dividend payments to Treasury—which was referred to as the "repayment probability." Treasury hired financial agents to conduct this analysis. Using publicly available information, these agents examined applicants' capital structure, asset quality, earnings capacity, and access to funding to develop a repayment probability estimate. According to Treasury officials, the purpose of the repayment probability analysis was to provide a forward-looking approach to help ensure that participants would generate enough future income to repay the SBLF investments and not solely rely on a determination of the applicant's financial condition information from their respective regulators. According to Treasury officials, the Application Review Team reviewed the repayment probability estimate and, if needed, updated the estimate to incorporate confidential supervisory information.

- *Sector analysis:* The Application Review Team reviewed sector analyses, on an as needed basis, on current industry trends and developments in the small bank credit sector because comparatively little market research was available. For example, some of the sector analyses included analysis of regional economies or summaries of important industry information, such as proposed regulatory and

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

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

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

- *Small business lending plans:* The Application Review Team summarized input from SBLF Program Office's evaluation of applicants' small business lending plans. The evaluation included the projected increase in small business lending, experience in small business lending, and plans to meet the needs of small businesses or provide appropriate outreach.[19]

- *Application Review Committee input:* The Application Review Team considered input from the Application Review Committee, which was made up of detailees from the FDIC, Federal Reserve, and OCC who were experienced in bank examinations.[20] Treasury established the Application Review Committee to further help ensure consistent treatment of bank applicants. The Application Review Committee was responsible for all bank applications that may have warranted additional review. For example, the Committee reviewed all applicants that receive a CAMELS composite rating of "3," had adverse performance ratios, or received inconsistent supervisory consultation from the relevant state and federal regulators.[21] In addition, the Application Review Committee took a "second look" at applicants deemed not viable by their respective regulators to ensure that the supervisory consultation process had been applied consistently

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

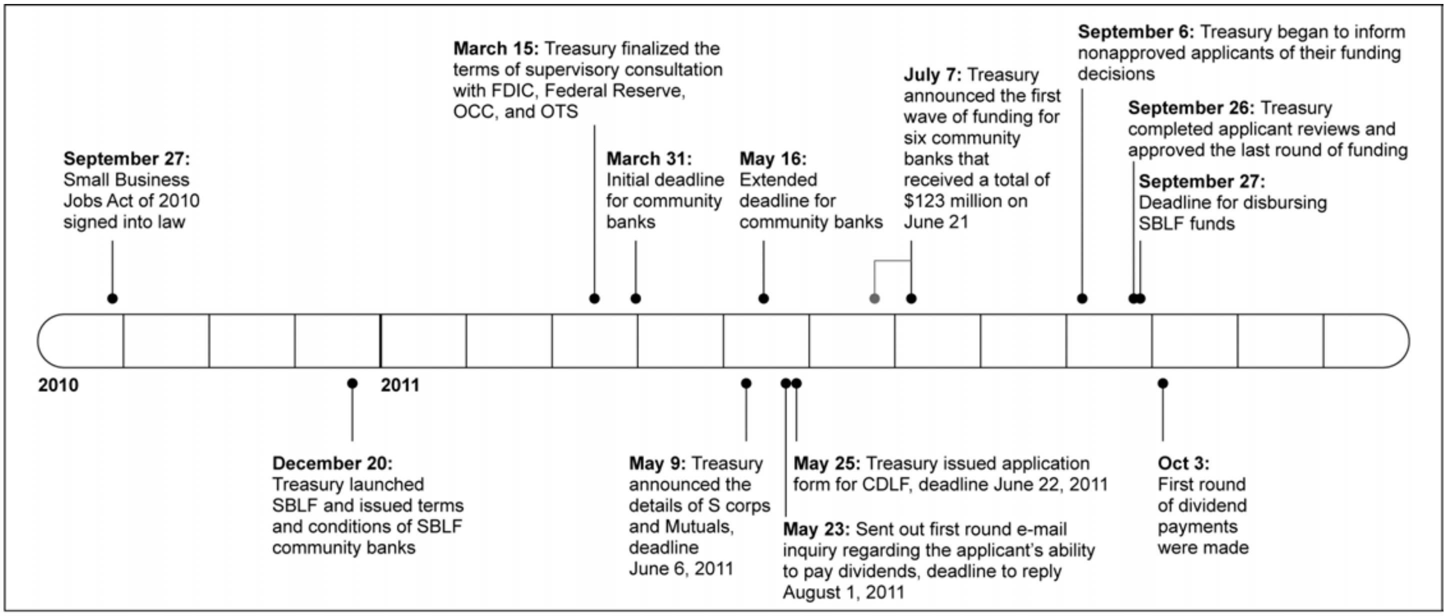
Treasury officials acknowledged that the initial repayment probability provided by the financial agents did not reflect regulators' views of the financial condition of the banks, especially confidential information concerning adversely classified assets. According to Treasury officials, this was due to the financial agents' reliance on only publicly available information to develop the repayment probability. Therefore, additional steps were taken to revise the estimates in certain cases. Treasury officials explained that the Application Review Team updated the probability estimate with confidential supervisory information in certain cases to help inform Investment Committee's evaluations. While these updated repayment probability estimates were considered, they were not recorded in Treasury's database. However, Treasury officials explained that this updated information was typically included in either the Application Review Team's recommendation memorandum to the Investment Committee or the Investment Committee minutes.[30]

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

Treasury faced multiple delays in implementing the SBLF program and disbursing SBLF funds by the statutory deadline of September 27, 2011. Treasury launched the program in December 2010 and had initially intended to start approving applications by mid-January 2011 and begin closing the application window by early April 2011. However, Treasury extended the application deadline for community banks from March 31 to May 16, 2001. In addition, Treasury did not begin the application process for banks that were S Corps and Mutuals and CDLFs until May 12, 2011, and set application deadlines for these institutions for June 6, 2011, and June 22, 2011, respectively. Because of these implementation delays, Treasury did not disburse any funds until the end of June 2011, and finished approving the applicants on September 26, 2011, a day before the funding deadline (see fig. 2).

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

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



Source: GAO.

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

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

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

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

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

Program Requirements and Dividend Restrictions

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

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

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

According to industry representatives, many banks had not realized that demonstrating their ability to pay dividends was a requirement for eligibility and, therefore, viewed Treasury's request for information on dividend restriction as a new requirement that was added subsequent to the application process. These representatives noted that the requirement that participants be able to pay dividends was not explicitly communicated when the information on SBLF was first posted on SBLF's website in December 2010.[33] For example, it was not included in the initial guidance, the application form, or the question-and-answer section on the website. This program requirement was also not mentioned in Treasury's initial outreach efforts (e.g., webinars and conferences). Similarly, officials from FDIC, Federal Reserve, and OCC also told us that Treasury's decision to not fund banks with dividend restrictions had not been explicitly stated when the program was established in December 2010. In addition, the regulators noted that Treasury officials did not discuss this issue with them until early May 2011.

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

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

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

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

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

Status of Applications

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

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

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

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

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

[35] GAO/AIMD-00-21.3.1.

Characteristics of Applicants and Participants and Factors Affecting SBLF Participation

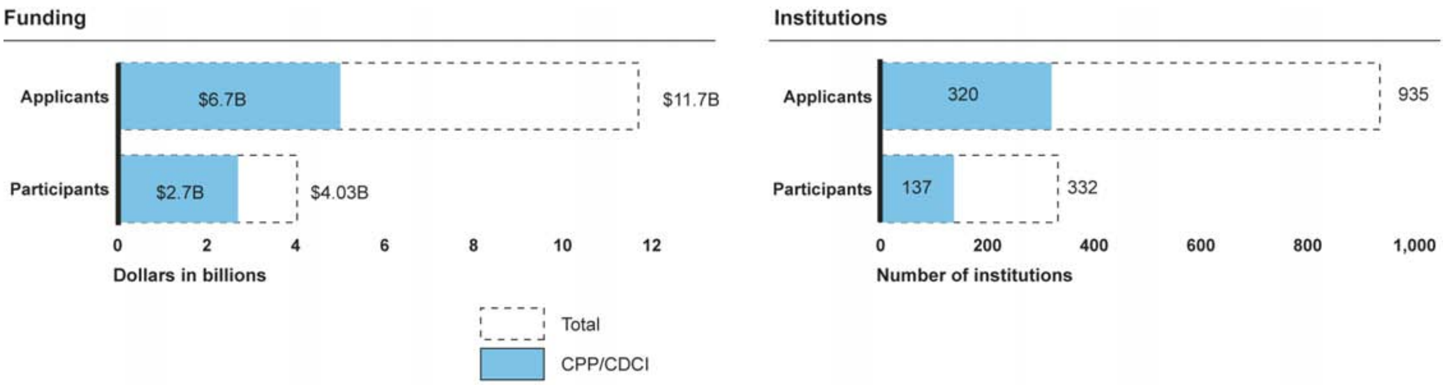
Fewer institutions applied to SBLF and received funding than initially anticipated. Although SBLF's authorizing legislation provided up to $30 billion for investing, Treasury expected program participation to be lower and budgeted $17.4 billion in SBLF investments in its fiscal year 2011 budget request,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

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

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

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

Figure 3: SBLF Applicant and Participant Data



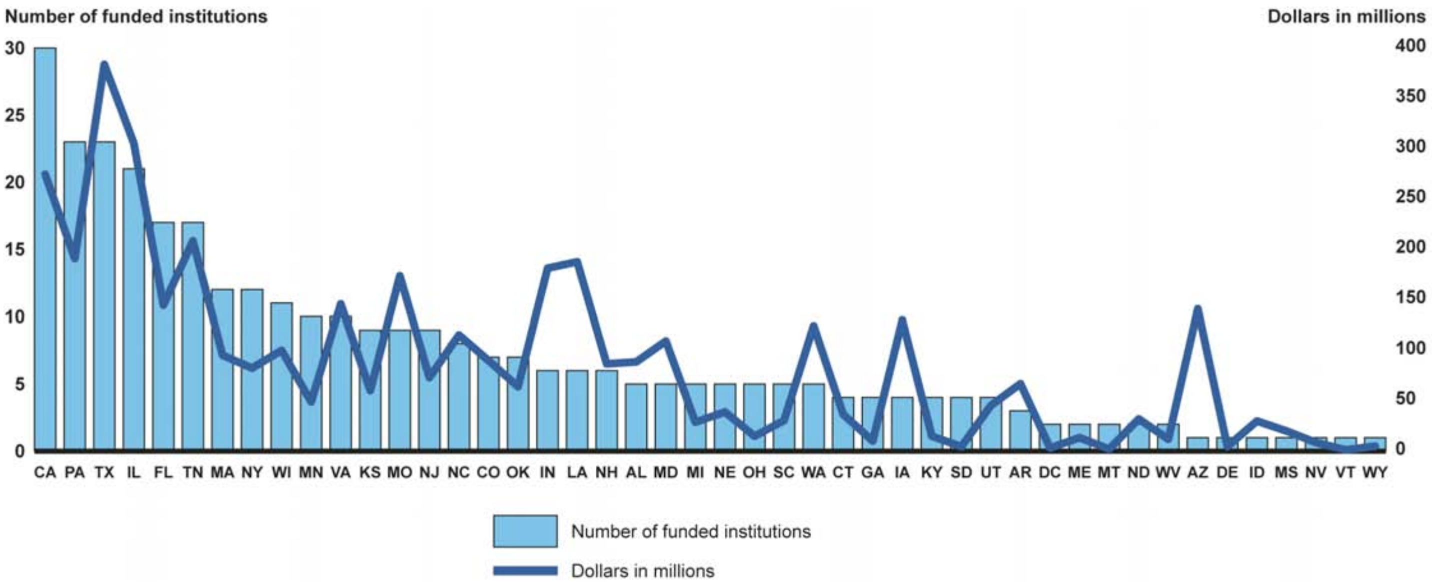
Source: GAO analysis of Treasury data.

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

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

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

Figure 4: SBLF Investments by State



Source: GAO analysis of Treasury data.

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

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

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

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

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

- *Capital ratios.* Both SBLF applicants and participants had less capital than their nonapplicant peers. The risk-based capital ratio—the ratio of total capital to risk-weighted assets—was about 15 percent for both SBLF applicants and participants, compared with roughly 19 percent for peers.[40]

- *Small loan portfolio.* Both SBLF applicants and participants had a smaller proportion of certain small loans on their balance sheets—that is, loans of less than $1 million for business and commercial real estate and less than $500,000 for farms—than nonapplicants.[41] For SBLF applicants small loans on average comprised 57 percent of loans, whereas participants had an average of 56 percent. For peer banks, the average was 62 percent.

- *Asset quality.* SBLF participants compared more favorably to applicants that were not funded and their peers in asset quality. Problem loans, a measure of asset quality, averaged 2.5 percent for SBLF participants compared with 5.7 percent for applicants that were not funded and 3.8 percent for peers.

- *CAMELS composite ratings.* On average, SBLF participants also had better CAMELS composite ratings than applicants that were not funded. SBLF banks averaged a CAMELS composite rating of 2.0, while applicants that were not funded averaged a CAMELS rating of 2.7, indicating some areas of supervisory concern. Nonapplicant peers had an average CAMELS composite rating of 2.1.[42]

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

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

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

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

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

Figure 5: Factors Affecting Banks' Participation in SBLF

Most important reason for not applying to SBLF							Most important reason for applying to SBLF		
Little or no anticipated demand for small business credit	Preference to avoid participating in government programs	Other (e.g., no need for additional funding, not eligible to participate)	SBLF terms were not favorable	SBLF less financially attractive compared to market alternatives	Application process was too burdensome	Plan to avoid taking on new obligations under current economic conditions	Source of capital to meet growing demand for small businesses credit	Financially attractive compared to market alternatives	Offers ability to refinance CPP/CDCI funds
29%	25%	18%	9%	8%	6%	5%	41%	35%	18%

Source: GAO survey results.

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

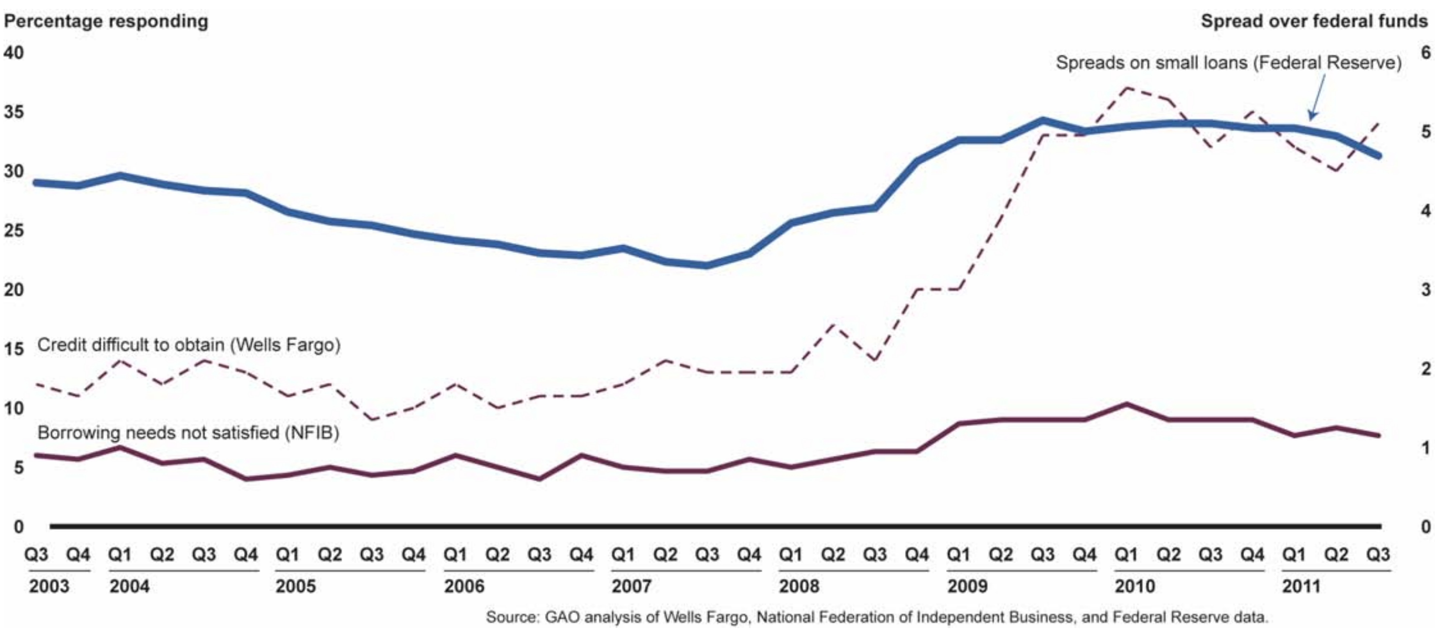
[43] GAO conducted a nationally representative survey of 794 banks, thrifts, and bank and thrift holding companies with total assets of less than $10 billion to gather information on their reasons for choosing to apply or not apply for SBLF. The final sample included 794 banks out of a total population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

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

Credit Conditions Remain Challenging for Small Businesses

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

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



Source: GAO analysis of Wells Fargo, National Federation of Independent Business, and Federal Reserve data.

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

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

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

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

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

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

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

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

Treasury faces a number of challenges as it moves forward in finalizing long-term plans to monitor SBLF participants and evaluate the SBLF program. First, Treasury will likely need to monitor SBLF participants without direct input from the federal regulators. According to Federal Reserve, OCC, and FDIC officials, there are currently no plans to coordinate with Treasury in monitoring SBLF banks. Regulators noted that their role, as defined by the statute, was to provide input to Treasury about the banks' financial viability during the application process. The statute does not give the regulators a role in monitoring SBLF banks, and regulators stated that SBLF banks will not be treated differently or have their own set of exam procedures during their supervisory examinations. One agency noted that they will review bank lending practices as part of the regular examination process. Second, the relationship between small business lending and job growth is complex, and making conclusions about the impact of the program on employment based on lending at SBLF banks will not be straightforward. Third, while using a control group to assess performance is a best practice, any assessment could be complicated by the fact the SBLF banks will report their small business lending in a way that is inconsistent with call reports of non-SBLF banks (the peer group). For example, as noted earlier, SBLF considers small loans to be those under $10 million, whereas the call reports collect data on loans under $1 million (or under $500,000 in the case of farm-related loans). Without comparable data for peers, measuring the impact it of SBLF on small business credit availability will be difficult.

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

[45] GAO/AIMD-00-21.3.1.

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

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

Conclusions

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

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

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

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

Recommendations for Executive Action

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

- To promote transparency and improve communication with SBLF participants and other interested stakeholders, such as Congress and the bank regulators, Treasury should apply lessons learned from the application review phase of SBLF to help improve its communication strategy going forward.

- To enhance the transparency and accountability of the SBLF program, Treasury should finalize (1) procedures for monitoring participants, including procedures to ensure that Treasury is receiving accurate information on participants' small business lending and (2) plans for assessing the performance of the SBLF program, including measures that can isolate the impact of SBLF from other factors that affect small business lending.

Agency Comments and Our Evaluation

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

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

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

A. Nicole Clowers
Director
Financial Markets and Community Investment

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Appendix I: Objectives, Scope, and Methodology

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

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

To identify applicants that fell outside of Treasury's stated evaluation parameters, we obtained data from Treasury, FDIC and SNL Financial (SNL) for all applicants on key inputs that Treasury used to inform its funding decisions, including CAMELS composite ratings, repayment probability, performance ratios, lending plan scores, dividend restriction information, and results of regulators' financial viability assessments. To assess the reliability of Treasury's data, we (1) performed electronic checking for errors in accuracy and completeness; (2) reviewed related documentation, such as minutes from the Application Review Committee and Investment Committee; and (3) held numerous meetings and remained in ongoing correspondence with Treasury to discuss data fields, analysis procedures, and weekly data updates. When we found inconsistencies, for example, between the weekly data updates or between the data and published information, we clarified them with Treasury. For example, during our interviews with Treasury, we learned that 60 applicants were approved by Treasury but did not close and were labeled in the same category (“withdrawn”) as applicants that were not approved. After clarifying and resolving our questions pertaining to the data, we concluded that the updated data set was reliable for the purpose of identifying applicants that fell outside of Treasury’s stated evaluation parameters.

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

Table 1: Main Parameters Treasury Used for Evaluating SBLF Applicants

Key Data	Parameters
Eligibility	Treasury determined only all approved applicants must first pass the initial eligibility check .
Positive financial viability	Treasury determined only all approved applicants must first receive a positive financial viability assessment from their respective regulators.
CAMELS composite ratings[a]	Treasury considered CAMELS composite ratings of 1, 2 or 3 as acceptable. Per the legislation, problem banks (i.e., banks with CAMELS composite ratings of 4 and 5) were not eligible.
Repayment probability estimate	Treasury determined that repayment probability of 80 percent as the minimum acceptable. An initial estimate was developed by financial agents. Treasury reviewed this initial estimate and, if needed, updated the estimate to incorporate confidential supervisory information.
Key performance ratios	Treasury considers the following as thresholds that would require further review: • *Classified assets ratio:* Classified assets/Net Tier 1 capital + allowance for loan and lease losses (ALLL): greater than 100 percent[b] • *Nonperforming loans ratio:* Nonperforming loans (NPLS) + other real estate owned (OREO) /Net Tier 1 capital + ALLL: greater than 40 percent • *Construction and development loans:* Construction and development loans/Total risk-based capital: greater than 300 percent[c]

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

Source: GAO summary of Treasury documentation.

[a]This exclude CDLFs, because CDLFs do not face the same regulatory reporting requirements as banks and thus do not have supervisory data.

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

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

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

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

Because our findings are based on a nongeneralizable sample, they cannot be generalized to all applicants. However, because they represent significant deviations from Treasury's stated evaluation parameters, our analysis provides useful examples of how Treasury used these inputs in making funding decisions. As part of this analysis, we reviewed minutes from the Application Review Committee and Investment Committee, and interviewed Treasury officials. Our criteria for assessing Treasury's evaluation process drew from GAO's *Standards for Internal Control in the Federal Government* and past GAO work, particularly on CPP.[1]

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

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

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

[1] GAO/AIMD-00-21.3.1.

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

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

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

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

Source: GAO survey results.

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

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

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

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

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

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

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

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

Source: GAO survey results.

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

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

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

Responses		%	95 percent confidence interval-lower bound	95 percent confidence interval-upper bound
	Not a reason	9	3	19
It offers the ability to refinance Capital Purchase Program (CPP) funds through the SBLF program.	A reason	31	20	44
	Not a reason	69	57	80
Other			18	68
			32	82

Source: GAO survey results.

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

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

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

Source: GAO survey results.

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

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

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

Source: GAO survey results.

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

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

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

Source: GAO survey results.

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

Appendix III: Comments from the Department of the Treasury

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

December 1, 2011

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

Dear Ms. Clowers:

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

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

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

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

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

Sincerely,

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

Appendix IV: GAO Contact and Staff Acknowledgments

GAO Contact

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

Staff Acknowledgments

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

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