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U P D A T E

News of Developments in the Financial Sector and Related Areas

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Capital for Banks
Small Business Lending Fund

The Treasury has released its Guide for depository organizations to participate in the Small Business Lending Fund. An application for participation is required to be filed by March 31, 2011. The Small Business Jobs Act of 2010 included the creation of a $30 billion Small Business Lending Fund (the "Fund") which will provide Tier 1 capital to participating depository institutions to support small business lending. The Fund authorizes the Treasury to make capital investments in depository institutions with an incentive structure to support new small business lending. The Fund encourages broader participation by depository institutions in that participants do not face existing TARP restrictions such as limitations relating to executive compensation. Current participants in TARP will be able to convert from the existing TARP program to the new program thereby substantially reducing their costs.

Depository institutions with less than $1 billion in assets would be able to receive capital infusions from the Treasury up to 5% of their risk-weighted assets. Depository institutions between $1 billion and $10 billion in assets would be eligible to receive up to 3% of their risk-weighted assets. To participate, depository institutions will have to be recommended by their primary bank regulator. Depository institutions on the FDIC problem bank list or that have been removed from the problem list for less than 90 days are not eligible to participate. The Fund defines a problem bank as a depository institution having a CAMELS composite rating of 4 or 5, or such other list designated by the FDIC. The Fund also provides that simply because a bank has a CAMELS rating of 3 or better that the Treasury Department still has the discretion to deny an application of an eligible institution. The application is available at SBLFApps@do.treas.gov.

The Treasury has the authority to permit participation by an institution that would not otherwise be eligible conditioned on private matching investments. In this instance, the institution would be eligible to receive a capital infusion not to exceed 3% of risk-weighted assets based on private matching investments and subordinate to the capital infusion to be received from the Treasury.

An applicant must deliver with its application for participation a small business lending plan describing how its business strategy and operating goals will allow it to address the needs of small businesses in the area it serves, as well as a plan to provide linguistically and culturally appropriate outreach, where appropriate. The form for preparing the plan is available at www.treasury.gov/SBLF. The plan will be confidential supervisory information and not available to the public. The term "small business lending" means (i) commercial and industrial loans, (ii) owner-occupied non-farm, non-residential real estate loans, (iii) loans to finance agricultural production and other loans to farmers, and (iv) loans secured by farm land. No loans that have an original amount greater than $10 million or to a business with more than $50 million in revenues are eligible.

The initial dividend rate for the capital investment provided by the Treasury under the proposed program will begin at 5%, with reductions to as low as 1% if a bank demonstrated specific levels of increased small business lending. During the initial two-year period of participation in the program, participants would receive decreases quarterly in the dividend rate based on incremental business lending they achieve over the two-year period, down to a minimum dividend rate of 1%. Banks would realize the reduction in the dividend rate sooner if they made earlier, but consistent progress towards increased lending. Changes in the rate will be measured against a baseline of the average amount of small business lending reported by the bank during the period of July 1, 2009 through June 30, 2010, less adjustments for loan charge-offs and loans acquired through purchase and merger transactions.

During the first two years, if small business lending has increased less than 2.5%, the dividend rate will be 5%; if small business lending has increased by 2.5% or greater but less than 5%, the dividend rate will be 4%; if small business lending has increased by 5% or greater, but by less than 7.5%, the dividend rate will be 3%; if small business lending has increased by 7.5% or greater, but less than 10%, the dividend rate will be 2%; and if small business lending has increased by more than 10%, the dividend rate will be 1%. If a bank increases its small business lending above the prior year baseline average, the rate adjustment will take effect the calendar quarter following the change in small business lending and will be payable in the second following quarter. At the end of the two years of adjustments, the rate in place at the end of the two year period will be the rate for the next 2 ½ years. In those situations where a bank has not increased its level of small business lending as of the end of the two year period, the rate will be changed to 7% for the next 2 ½ years. The rate would increase to 9% at the end of the 4 1/2 –year period following a bank's participation in the program. The capital investment by the Treasury must be repaid at the end of 10 years. The rates would be adjusted for subchapter S corporations to take into effect any differential tax treatment for participating subchapter S corporations.

Any business receiving a loan from a participating institution using funds received under the program is required to certify to the institution that the principals of such business have not been convicted of a sex offense against a minor. Participating institutions will probably need to obtain this certification from all borrowers since it may be difficult to determine which loans are made or not made under the program.

None of the proceeds provided under the Fund may be used to pay the salary of any individual engaged in any activities under the program who has been officially disciplined for viewing, downloading or exchanging pornography, including child pornography, on a Federal Government computer or while performing official Federal Government duties. This would appear to require an additional certification from all borrowers followed by an additional certification by a participating institution.

Our firm is experienced in transactions with the Treasury and available to assist institutions in their participation in the program.

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