Administration Announces New $30 Billion Small Business Lending Fund

Today, the President called on Congress to create a new Small Business Lending Fund. Under this proposal, $30 billion in TARP funds would be transferred, through legislation, to a new program outside of TARP to support small business lending. This new program complements other SBA lending initiatives the President has already announced – including support for higher SBA loan limits and extending Recovery Act provisions for higher loan guarantees and temporary fee eliminations – as well as tax cuts to encourage small businesses to invest, hire and raise their workers' salaries. These efforts for small business are a critical part of the President's overall approach to supporting job creation.

New $30 Billion Small Business Lending Fund

- ***Targeted at Community and Smaller Banks that Lend the Most to Small Businesses***
- ***Established Separately from TARP to Encourage Maximum Participation***
- ***Core Proposal for New Fund Would Be to Offer Capital Investments With Incentive for Banks to Increase Small Business Lending***
- ***Administration Will Discuss with Congress Additional Ideas to Enhance Credit for Small Businesses Through the Small Business Lending Fund***

Elements of New $30 Billion Small Business Lending Fund

1. ***Limited to Community and Smaller Banks Which Devote a Higher Share of Lending to Small Businesses***: The Small Business Lending Fund would support lending among small- and medium-sized banks (with assets under $10 billion). These banks devote the highest percentage of their lending to small businesses in their communities, accounting for over 50 percent of all small business loans nationwide, even though they make up only about 20 percent of all bank assets.

2. ***Program Would Be Separate and Distinct from TARP to Encourage Participation:*** By transferring, through legislation, $30 billion to a new program that would be distinct from TARP, the Administration's proposal would encourage broader participation by banks, as they would not face TARP restrictions.

3. ***A Core Function of New Fund Would Be Offering Capital With Incentives to Increase Small Business Lending:*** The Administration's core proposal for the new lending fund is an initiative to invest in smaller banks capital under terms that provide strong incentives to increase lending. As participating banks increase lending to small firms compared to 2009 levels, the dividend paid to Treasury on that capital investment would be reduced. This proposal has two key advantages:

    - ***Capital Could Be Leveraged Several Times to Support New Lending:*** While the Administration's proposal could provide $30 billion in capital to banks, these institutions would typically leverage that funding several times over when increasing lending. As such, that $30 billion could potentially support multiples of that amount in loans.

    - ***Incentive Structure Supports Immediate Increases in Lending Over 2009 Baseline:*** By reducing the dividend on the capital investment that community and smaller banks receive, based on increased lending over a baseline set using 2009 data, this program ensures that lenders have a strong incentive to increase total loans to small businesses. Because banks would get credit for any increase in lending during 2010, if they plan to join the program they should have an incentive to increase lending immediately so they could realize the benefits of a lower dividend rate on the investment as soon as they entered.

4. ***Administration Will Discuss with Congress Additional Ideas to Enhance Credit for Small Businesses Through the Small Business Lending Fund.*** While the Administration is presenting its plan to provide capital with an incentive structure to maximize small business lending, it looks forward to discussing with Congress other ways that – in addition to what is described above – the Small Business Lending Fund could be fully deployed.

Details of How the Core Proposal Could Work

The Administration's core proposal would be to use the Small Business Lending Fund to offer capital investments to community and smaller banks with an incentive structure to support new small business lending, as described below. The Administration is open to other designs for the fund, and will discuss ideas with Congress in the coming days and weeks.

One potential design for the proposal discussed above is the following:

- ***Banks Would Be Eligible to Receive Up to 3% to 5% of Risk-Weighted Assets***
    - Banks with less than $1 billion in assets would be eligible to receive capital investments up to 5% of their risk-weighted assets.
    - Banks with between $1 and $10 billion in assets would be eligible to receive up to 3% of risk-weighted assets.
    - To participate, banks would have to be approved by their primary federal regulator. Existing Capital Purchase Program participants with less than $10 billion in assets would be permitted to convert their capital to the new program.

- ***The Cost of Capital Would Be Reduced As Lending Increases:*** The dividend rate for a capital investment provided under the program would begin at 5%, but with reductions to as low as 1% if a bank demonstrates increased small business lending relative to a baseline set in 2009.
    - Banks could receive a 1% point decrease in their dividend rate for every 2.5% increase in incremental business lending they achieve over a two-year period, down to a minimum dividend rate of 1%.
    - Banks would realize this reduction in dividend rate sooner if they make early, but consistent progress towards increased lending.
    - For purposes of the program, banks would be able to receive the incentive on the basis of new lending beginning Jan. 1, 2010.
    - After five years, the dividend rate would be increased to encourage timely repayment.

<u>Example</u>

Bank A, with $500 million in risk-weighted assets, held $250 million in business loans the end of every quarter of 2009. In 2010, it applies for and receives approval to draw capital equal to 5% of its risk-weighted assets from the Small Business Lending Fund (the maximum allowable).

After drawing $25 million in capital from the fund, Bank A increased its stock of outstanding small business loans to $275 million by the end of two years (a 10% increase over the baseline). As a result, while it received capital with an initial dividend rate of 5%, that dividend rate would be decreased to 1%. The 1% dividend would then be locked-in, and the bank would benefit from this attractive rate for the following three years.