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Questions Surround Details of Small-Biz Lending Fund

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By Cheyenne Hopkins

WASHINGTON — As the House gave final approval Thursday to a bill that would create a $30 billion small-business lending fund, a top Treasury Department official said the administration would move as quickly as possible to implement the program.

"We obviously have to work with the regulators, but we feel that we can get this up and going expeditiously," said Gene Sperling, a counselor to Treasury Secretary Tim Geithner.

With President Obama expected to sign the bill into law on Monday, the Treasury is expected to begin working with regulators within a week to create the program's term sheet and application. Money from the program could be distributed to banks within two to three months.

"Obviously when you are dealing with safety and soundness and hundreds and hundreds of banks you have to make sure you get it right, but we very much understand the high importance of getting this up and running as quickly as possible and we believe that will be very doable," Sperling said.

Community bankers said swift implementation would be critical to the program's success.

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"It's not going to be helpful if it's a program on paper," said Paul Merski, senior vice president and chief economist for the Independent Community Bankers of America. "It needs to be rolled out very quickly and properly so that it's useful to banks."

But regulators still have a lot of issues to sort through, including how the capital will be treated, the criteria for approving an application, regulators' rules for underwriting of small-business loans and how banks can covert Troubled Asset Relief Program capital into the new program.

"Does the bank have to raise additional capital?" asked Jon Winick, the president of Clark Street Capital. "Is this a matching type program? How healthy does an institution have to be? Which of the [Camels] 3s are eligible? When are they even going to get this?"

Obama first suggested the fund nine months ago, but the bill has had a rocky journey. The Senate approved the bill Sept. 16 after months of debate over it. The House, which had passed its own version of the bill, accepted the Senate's changes, which included the addition of $12 billion of tax cuts for small businesses and an extension of the Small Business Administration. It passed the bill on Thursday by a vote of 237 to 187.

Under the program, banks with less than $10 billion of assets can apply for capital with an initial dividend payment of 5%. That required dividend would drop, however, as banks boosted their small-business lending. For example, if banks increased such lending by 10% after a year, the dividend would fall to 1%. The capital would be free of Tarp-like restrictions, such as warrants and executive compensation, that created a stigma for that program.

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But a main concern among bankers is just what criteria regulators will use to approve the capital injections. Banks on the Federal Deposit Insurance Corp.'s problem-bank list, typically those rated Camels 4 or 5, or banks that have been on that list within 90 days are excluded from participation. But — much like Tarp — the capital approval is on a case-by-case basis with regulators making recommendations to the Treasury.

"A lot of our clients have said they are interested in it if they can find out … what the ground rules are," said Bob Clarke, a senior partner at Bracewell & Giuliani LLP and a former comptroller of the currency. "That is the big problem with Tarp: we didn't know whether they would make it only available for healthy banks or evaluate unhealthy banks. … People are not going to waste time applying if they think there would not be any chance they would be approved or there is uncertainty if they would be approved."

The bill does allow banks that received funds from Tarp's Capital Purchase Program to refinance into the Small-Business Lending Fund as long as institutions have made all required dividend payments on time.

Industry observers said CPP banks would find the refinancing appealing because it gives them a chance to lower their dividend.

"The other type of institution that might be interested are institutions that have Tarp preferred and they can refinance under this program if they have a reasonable small-business plan," said Dwight Smith, a partner at Alston & Bird LLP.

But observers are also unclear on how regulators will classify the capital, an issue the bill left unsettled. "The next challenge will be what is counted as capital and what is counted as a loan," said James Ballentine, senior vice president of grassroots and political operations for the American Bankers Association. "The way the legislation is now it is not clear if it is counted as Tier 1 capital."

Rep. Melissa Bean, D-Ill., and House Financial Services Chairman Barney Frank attempted to clarify the capital treatment in a colloquy on Thursday.

"It is my understanding that these investments are meant to be counted as Tier 1 capital, Mr. Chairman is that correct?" Bean said.

"She is absolutely correct," Frank responded. "It is our understanding and the intention that this be treated as Tier 1 capital consistent with all other securities."

Kip Weissman, a partner at Luse Gorman, questioned whether the capital treatment would conflict with the upcoming Basel III rules, which place more emphasis on common equity ratios rather than Tier 1 capital. "This is not a hybrid instrument but it is not tangible common equity," Weissman said. "Basel clearly says the No. 1 form of equity is tangible common equity and this is not tangible common equity."

Under the bill, bank applicants must also submit a small-business plan to their primary regulator, but the legislation offers no guidance on what should be in the plan. Regulators must also write rules within 60 days that outline appropriate underwriting standards for small-businesses loans that count under the new program.

"The statute requires the regulators to issue guidance on underwriting standards so arguably you might be taking this money and envisioning a particular small-business lending plan and then confront these new underwriting guidelines you hadn't digested," Smith said.

Two other critical questions remain: Will bankers use the program, and if they do, will it result in more lending?

Some at least expected banks to apply for the funds.

"I have no doubt that it will be widely used because there are a lot of community banks that need to raise capital," Winick said.

But even if they take the money, it is unclear whether it will result in increased lending, they said.

"It creates the ability to lend," said Lawrence Kaplan, a lawyer at Paul, Hastings, Janofsky & Walker LLP. "You still have to bring the horse to water and force it to drink. It clearly changes the dynamic because it provides a mechanism to make sure there is credit out there when people say there is no credit. But what we don't know is if there is still demand out there."

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