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Lenders Take Issue with Terms of Small Business Lending Fund

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By Cheyenne Hopkins

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WASHINGTON — Recently released terms of the Small Business Lending Fund are fueling fears that may discourage participation in the program.

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While some bankers have expressed interest, many industry representatives were dismayed by the term sheet, which the Treasury Department quietly released shortly before Christmas. They cited concerns that the program will not count Small Business Administration loans as small-business lending; that it will have volatile interest rates; and that it will force institutions to find matching funds for any money they receive.

"I would have liked something simpler without all these traps," said Kip Weissman, a partner at Luse Gorman. "It's overengineered."

To be sure, some bankers remain excited about the new program, even with the restrictions on it.

"I think it's very positive," said Rusty Cloutier, the chief executive of MidSouth Bank in Lafayette, La.

He said MidSouth would apply to convert its $20 million in Troubled Asset Relief Program capital into SBLF funds. "I have trouble coming across anything negative other than people saying you are doing business with the government, and I'm already doing business with the government by being highly regulated," Cloutier said.

The program is also backed by several industry groups, including the American Bankers Association and Independent Community Bankers of America.

"This is another program that can possibly help small businesses," said James Ballentine, the senior vice president of grassroots and political operations for the ABA. "It is something that should be explored by the banks and that's something they will go through with this program."

But at least one group has turned against the small business fund. Tony Wilkinson, president of the National Association of Government Guaranteed Lenders, had lobbied for the idea when President Obama first suggested it last year. But the group pulled its support after the term sheet said SBA 7(a) loans and other government-guaranteed loans would not count as small-business loans for the purposes of the SBLF.

While the Treasury argues it has a long-standing policy not to let institutions "double dip" — benefit from two government programs at the same time — Wilkinson said the restriction came out of the blue.

"I've had multiple discussions with Treasury and they have never mentioned this before," he said. "From my perspective, they have just told the lenders doing the best job of getting capital into the hands of small businesses: 'Too bad.' "

Under the program, banks can apply for funds at an initial 5% dividend that would go lower if they do more small-business lending. By saying the guaranteed portion of SBA loans do not

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count, Wilkinson said, the Treasury is discriminating against SBA lenders, who are less likely to participate in the new program.

"I don't think SBA lenders will participate at the level they would have, because the cost of their participation will be higher than a conventional lender," he said.

Industry representatives are also concerned by language in the term sheet that appears to suggest a bank needs matching funds to receive government capital. According to one of the documents, the Treasury may determine that a bank receives SBLF capital "provided it raises separate matching funds from private, nongovernmental sources." The matching funds could be a condition of approval or concurrent with the receipt of funds.

"If the premise of this program is only for healthy institutions and institutions that haven't recently been under a government enforcement order, then I'm wondering why the government will require 50% of your small-business plan come from private-sector capital raises," said V. Gerard Comizio, a partner at the corporate department at Paul, Hastings, Janofsky & Walker. "My question there is are banks prepared for the possibility they may need to undertake a side-by-side capital raise in order to qualify for this program? Private-sector money costs capital and takes time."

Weissman said the dividend incentive structure is also inappropriately targeted at short-term interests. Under the program, the dividend starts at 5%, and can fall as low as 1% if banks increase their small-business lending. It can also rise as high as 9% if the funds are not paid back within 4 and a half years.

The SBLF calculates small-business loan growth, however, on a quarterly basis for the first two years and charges a variable interest rate.

"The No. 1 focus of the program is to stimulate small-business lending, but I was surprised to see a program focused on short, quarterly results," Weissman said. "I would have thought they would have repriced it annually or made it fixed. But if an institution has a bad quarter for loan growth, then the interest rate goes up, and I was surprised."

A Treasury spokeswoman said the quarterly will benefit banks, not harm them. She noted that banks would not have to wait a year to receive a dividend reduction if they boost small business lending.

Jon Winick, the president of Clark Street Capital Management, said the dividend structure combined with the 7(a) limitation will deter a number of institutions from applying for the program. He said the 1% dividend would apply to only a partial amount of capital received.

The program makes it "more difficult for banks to qualify for the lowest interest rate and add that your 7(a) is not part of the program, so as these rules come out its more challenging for the industry," Winick said. "It's still going to be the most attractive out there, but the higher the dividend rate, the more challenging it is to get the money out, the higher the cost of the capital."

Like many others, he questioned why the Treasury issued the term sheet with little fanfare, even though Obama himself has actively promoted the program.

"The way they released it was almost like they were releasing it so no one would hear about it," Winick said. "It was released in a way you would release a presidential pardon."

In its defense, the Treasury said that many of the program's terms were set in statute by Congress.

"The parameters of this lending program were clearly defined by Congress in the Small Business Jobs Act, and we're implementing the fund as prescribed," said Don Graves, the Treasury's deputy assistant secretary for small business.

Some bankers are still weighing whether to participate.

Ron Paul, CEO of the $2 billion-asset EagleBank in Bethesda, Md., said that the program was attractive but won't address liquidity also needed for loans.

"What we've done is we've given community banks the ability of strengthening their capital position, when you strengthen your capital position, you can go out and make more loans," Paul said. "The Small Business Lending Fund is the impetus to make those, but the source of cash to fund those loans is very restrictive. … Congress has confused capital with liquidity and capital is only one-tenth of what you need to make that lending."

Paul said he was disappointed the program does not include non-owner-occupied commercial real estate loans as small-business loans — a restriction mandated by Congress.

But Thomas Gronstal, chairman of the Conference of State Bank Supervisors and head of the Iowa Division of Banks, said he has already seen interest in the program.

"I think you are going to see community banks that see an opportunity to grow their

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businesses, that don't have an opportunity to get this amount of capital any other ways," Gronstal said.

Winick agreed some banks are likely to benefit.

"There is more of a need for this program defensively than offensively," Winick said. "It's 'I need a capital buffer to absorb the future losses amongst legacy portfolios so I can go out and cleanse my balance sheet and be a more active lender again.' "

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