# Financial Crisis Management Alert

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## The TARP Tease, or $30 Billion in Change to Believe In?

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The reaction was decidedly mixed to President Obama's proposal in his State of the Union address on January 27 to take $30 billion of the money that mega-banks have repaid under the Troubled Asset Relief Program (TARP) and use it to help community banks make loans to small businesses. Some politicians pointed out that TARP requires that recouped funds must be used to reduce the federal budget deficit, adding that TARP was not intended to serve as a revolving credit line (or, less generously, as a "piggy bank") to be used at the president's behest. Community bankers cautiously seemed to welcome the concept, but wondered about the red tape, the regulatory requirements, and the stigma that they would face if they became recipients of TARP money, even if they just were going to lend it right out to loan-thirsty business borrowers.

Last week, the White House fine-tuned its proposal. It now has its own name -- the Small Business Lending Fund (SBLF) -- and the program is intended to make the SBLF available to community banks with assets under $10 billion. The program would transfer $30 billion of TARP money to the SBLF, which would offer capital investments to community and smaller banks. Significantly, the

SBLF would be distinct from TARP to encourage broader participation by banks, and to free participating banks from TARP restrictions such as warrant and executive compensation limitations; that obviously is a big plus when compared to the initial January 27 concept. Of course, the devil is in the details, and the fine print has not yet been finalized and released.

**The New Proposal**

Under the Obama administration plan announced last week, banks with less than $1 billion in assets would be eligible to receive capital investment of up to 5 percent of their risk-weighted assets, while banks with between $1 billion and $10 billion in assets would be eligible to receive capital investment of up to three percent of their risk-weighted assets.

Moreover, the cost of this capital to an individual bank would be reduced as its lending increased. For example, under the current version of the plan announced last week, the dividend rate for a capital investment provided under the program would begin at 5 percent, but could be reduced to as low as one percent if a participating bank demonstrates increased small business lending relative to 2009. In particular, a bank could receive a 1 percent decrease in its dividend rate for every 2.5 percent increase in incremental business lending it achieves over a two-year period, dropping the minimum dividend rate down to 1 percent.

Thus, as an example, assume that a bank with $500 million in risk-weighted assets held $250 million in business loans at the end of every quarter of 2009. Further assume that the bank applies for and receives approval to draw capital equal to five percent ($25 million) of its risk-weighted assets from the SBLF, which is the maximum allowable.

Now, assume that after drawing that capital from the SBLF, the bank increases its outstanding small business loans to $275 million by the end of two years, amounting to a 10 percent increase over the 2009 baseline. As a result, while it received capital with an initial dividend rate of five percent, that dividend rate would be decreased to 1 percent. Moreover, according to the proposal, the 1 percent dividend would be locked-in, and the bank would benefit from this rate for the following three years.

**The Crystal Ball Says...**

Is the SBLF likely to take effect? The White House acknowledges that the plan requires legislation, which may doom it from the outset, given the gridlock in Washington. (The separate announcement by Treasury Secretary Timothy Geithner last week about a new program to make $1 billion of TARP funds available to about 200 community development financial institutions, at a 2 percent dividend rate rather than the usual 5 percent fee, does not require any approval by Congress; that alone is enough to make certain that this program will proceed.)

Still, the SBLF plan has a lot of potential. It targets -- but in a positive way -- community banks and seeks to promote something that they do so very well:

extending credit to small businesses. Let's remember that community banks make more than 50 percent of all small business loans nationwide, even though they have only about 20 percent of all bank assets. (Compare that to the fact that the largest banks, which received the bulk of TARP funds, in the aggregate account for a much smaller percentage of loans to small businesses. If a small business is looking for a loan, who is it gonna call? That's right -- its local community bank.)

Which brings us to the key potential problem with the SBLF: It may be that the reason more small business loans are not being made is not because community and other banks are not lending, but because small businesses are not borrowing. If -- or, to be more precise, *when* -- that changes, and when more jobs are created and consumers start buying again, then loans will follow, using the SBLF or otherwise. Of course, one could try to generate more loans now by dropping underwriting standards, but there probably is not much political will to do that; opponents undoubtedly would say that that was what got so many big players into the mess we all are in today.

Certainly, one also could wonder whether $30 billion is sufficient in this economy to accomplish the Obama administration's intended goal of increased business borrowing, even recognizing that the funds could be substantially leveraged; $30 billion is only about 4.3 percent of the $700 billion or so that currently exist in outstanding small business loans. If the SBLF does get enacted, and if other proposed steps take effect, including having Congress pass legislation to raise the Small Business Administration (SBA) Express loan cap from the current $350,000 to $1 million, and if there also is an increase in the number and amount that can be borrowed under more traditional SBA loans, we all might find that we are beginning our way out of this great recession.