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New Capital For Community Banks - Is The Small Business Lending Fund Right For You?

On September 27, 2010, President Obama signed into law the Small Business Jobs Act of 2010 (Act), which, among other things, created the Small Business Lending Fund Program (Program) to facilitate up to a $30 billion capital investment in community banks. This article is intended to briefly describe the eligibility criteria, the application process, and a bank's obligations if it wants to participate in the Program.

Eligibility

Under the Program, the U.S. Treasury may invest in preferred stock and other debt instruments issued by financial institutions. To be eligible, a bank, or if the bank is controlled by a bank holding company, the bank holding company, must have total assets of $10 billion or less. The U.S. Treasury must consult with the bank's regulators to determine if banks should receive the investment. Institutions on the FDIC's problem-bank list as of, or within 90 days prior to, the date of the application, are ineligible to participate in the Program. Eligible institutions may use the Program to refinance an existing TARP investment as long as the institution has not missed more than one TARP dividend payment.

Amount

Investments in banks having assets of $1 billion or less are limited to an amount equal to 5% of the bank's risk-weighted assets. Investments in banks having assets exceeding $1 billion but less than $10 billion are limited to an amount equal to 3% of the bank's risk-weighted assets. All investments under the Program will be reduced by the amount of the existing TARP investment, if any, made in such institution (unless the Program funds are used to refinance the TARP investment). As of the date of the writing of this article, it is unclear whether the investment will constitute Tier 1 capital.

Application

As part of the application, an applicant must submit to its primary regulator a small business lending plan describing how the applicant intends to use the new capital to address the needs of small businesses in the areas it serves. Small business lending includes commercial and industrial loans, owner-occupied non-farm, nonresidential real estate loans, loans to finance agricultural production, and loans secured by farmland, but excludes loans in excess of $10 million and loans made to any business that exceeds $50 million in annual revenues. The plan must also describe how the applicant will "provide linguistically and culturally appropriate outreach and advertising" regarding the availability and application process for new credits.

Repayment

Treasury's investment must be repaid within 10 years. While the investment is outstanding, the rate at which dividends are payable varies between 1% and 7%, with an initial rate of 5%, and is wholly dependent upon the amount of increase in the bank's small business lending following Treasury's capital investment. If Treasury's investment is not redeemed on or before 4 ½ years following its investment, the dividend rate increases to 9%.

While the capital available to community banks pursuant to the Program is indeed enticing, applicants should be aware that the rules under the Program are subject to change at any time and any recipient will be bound by those changes until the investment is repaid.

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