

December 22, 2010

Treasury Releases Application Guidance and Term Sheets for Participation in Small Business Lending Fund

CONTACTS

[Chet A. Fenimore](#)

Managing Partner
111 Congress Avenue, Suite 820
Austin, Texas 78701
Direct: (512) 583-5901
cfenimore@fkhparkers.com

[Geoffrey S. Kay](#)

Partner
111 Congress Avenue, Suite 820
Austin, Texas 78701
Direct: (512) 583-5905
fkay@fkhparkers.com

[Lowell W. Harrison](#)

Partner
111 Congress Avenue, Suite 820
Austin, Texas 78701
Direct: (512) 583-5905
lharrison@fkhparkers.com

[Stephanie E. Kalahurka](#)

Associate
111 Congress Avenue, Suite 820
Austin, Texas 78701
Direct: (512) 583-5903
skalahurka@fkhparkers.com

ABOUT FKH PARTNERS

Our firm focuses on representing banks and other financial institutions throughout the United States. We focus our practice on matters that require the attention, extensive experience, expertise and reputation of our partners. As such, we provide partner-intensive service. At all times, our clients are afforded the direct personal attention of partners having expertise and sophistication with respect to the issues. We provide legal advice on all facets of banking, corporate and regulatory law on both a state and federal level.

Three months ago, President Obama signed into law the Small Business Jobs Act of 2010 that creates, among other things, a \$30 billion Small Business Lending Fund (“SBLF”) pursuant to which the United States Department of the Treasury (“Treasury”) will provide Tier 1 capital investments to community banks and other eligible institutions in an effort to promote lending to small businesses. Earlier this week, Treasury released more comprehensive guidance for institutions that are interested in participating in the SBLF, including the applicable term sheets and information regarding the application process.

Eligibility. Pursuant to the SBLF, “eligible institutions” with less than \$10 billion in assets are eligible to apply for participation. Eligible institutions generally include insured depository institutions, bank and savings and loan holding companies, and certain community development loan funds. Institutions that are on the FDIC’s problem bank list (or have been removed from the list within the previous 90 days) are not eligible to participate. Although mutual institutions, Subchapter S corporations, and community development loan funds will be eligible to apply, it is important to note that the current guidance released by Treasury earlier this week does not apply to these institutions. Treasury has indicated that it will publish separate terms for these institutions at a later time.

Cost of Funds. The SBLF allows eligible institutions with assets of \$1 billion or less to apply for a capital investment from Treasury not exceeding 5% of its risk-weighted assets. Eligible institutions with assets of between \$1 billion and \$10 billion may apply for a capital investment of up to 3% of its risk-weighted assets, which investment will occur through the sale of senior perpetual noncumulative preferred stock to Treasury. Depending upon the participating institution’s volume of small business lending, the dividend rate on the preferred stock issued to Treasury can decrease to as low as 1% over the first four and one-half years of the investment.

As we have described in more detail in our [prior client alert](#) and as is disclosed in Treasury's [Getting Started Guide](#), the dividend rate on funds received under the SBLF will go down as the institution's volume of qualified small business lending increases. Treasury's new guidance has clarified that the baseline for determining this increase will be calculated as the average amount of small business loans outstanding during *the four quarters ending June 30, 2010*. Accordingly, for the purposes of determining the initial dividend rate and the corresponding decreases to the initial dividend rate, participating institutions will generally get the benefit of any increase in small business lending after June 30, 2010 (even if those increases occurred prior to the actual funding under the program). The initial dividend rate will be no greater than 5%, and can be as low as 1% depending on the volume of increase in the institution's small business lending since June 30, 2010.

Importantly, the dividend rate reductions resulting from increases in qualified small business lending *are applicable only to those funds which represent the institution's actual increase in small business lending*, and not on the entire amount of Treasury's investment. Also, if the institution has not experienced an increase, or has experienced a decline in its small business lending during the initial two years of the investment, then that institution's dividend rate will remain static at 5% during the first two years *and will increase to 7% at the end of the initial two-year period*. All of these rate contingencies should be considered in the overall cost-benefit analysis for any institution considering participation in the SBLF. For further reference regarding the material terms of the preferred stock investment, please refer to [Summary of Terms for the Small Business Lending Fund Senior Preferred Stock](#).

Application Process. In connection with its release earlier this week, Treasury provided a comprehensive [Getting Started Guide](#) that answers the most commonly asked questions regarding: (i) eligibility for participation in the SBLF; (ii) the process for applying for participation in the SBLF; (iii) the method for calculating the dividend rates that will be paid on preferred stock issued to Treasury; and (iv) ongoing obligations of the participating institution after funding has been received. If your institution is considering whether to participate in the SBLF, we recommend that you carefully review Treasury's [Getting Started Guide](#), especially noting the following:

- Applications for participation in the program are due by March 31, 2011. The application process is relatively simple. Treasury has provided a [one-page application form](#) to be completed and submitted to Treasury and an additional [three-page small business lending plan](#) that must be prepared and submitted to the state and federal regulators of each applicant financial institution. Applicants with holding companies must also submit the application and lending plan to the Board of Governors of the Federal Reserve. Submitting an application does not obligate an institution to participate in the program. Applications may be withdrawn at any time, even after receipt of Treasury's preliminary approval.
- Once applications have been evaluated, Treasury will notify applicant institutions as to whether they have been approved for participation. *Significantly, Treasury has*

indicated that some institutions may be approved subject to an additional requirement to raise separate matching funds from private, nongovernmental sources. This additional requirement will not be applicable to all institutions that are approved for participation, and Treasury's guidance does not disclose the specific circumstances under which this additional condition will apply. Any required matching funding must be in place either prior to or concurrent with Treasury's funding under the SBLF. Capital raised after September 27, 2010 will generally qualify for the purposes of satisfying any matching funds requirement.

- Upon receipt of preliminary approval, the approved institution will have a reasonable time to decide whether it would like to proceed to closing. If the institution decides to continue, Treasury will assign a law firm (representing Treasury) to work with the institution and its counsel. The parties will then negotiate and enter into the necessary agreements (including, among others, a Letter Agreement and a Securities Purchase Agreement) to close and fund the transaction.
- It is important to note that because the SBLF program is designed to promote small business lending and is not a capital program (i.e., TARP), all holding company participants will be required to downstream at least 90% of the SBLF proceeds to its subsidiary banks.

Refinancing TARP Securities. Institutions that have participated in Treasury's Troubled Asset Relief Program ("TARP"), Capital Purchase Program ("CPP") may be eligible to refinance their outstanding CPP investment under the SBLF and receive the benefit of the program's decreasing rate structure. CPP participants will generally be eligible to apply if the institution (i) is in material compliance with all of the terms, conditions and covenants applicable to the CPP investment, and (ii) has not missed more than one dividend payment. Interestingly, applications by CPP participants will not be considered for approval that is contingent on raising matched funding from private, nongovernmental sources. In addition, participating institutions may not have CPP and SBLF investments outstanding at the same time. Accordingly, CPP participants that are approved to participate in the SBLF must repay the entire amount of their prior CPP investment (together with all accrued and unpaid dividends), even if the CPP investment is greater than the amount that the institution will receive under the SBLF.

Warrants issued by institutions under the CPP program will remain outstanding until they are repurchased by the institution. Until the CPP warrants are repurchased or until they expire, Treasury (or any subsequent holder of the warrants) will continue to have the ability to exercise those warrants by paying the applicable exercise price (generally a price equal to the market price for the Company's common stock on the date of the CPP investment) to the Company.

Unlike other participants in the SBLF, CPP participants seeking to refinance the prior investment may be subject to an additional fee payable to Treasury in the event they do not achieve an increase in the institution's qualified small business lending. In particular, if the institution's qualified small business lending does not increase, relative to its baseline amount,

during the first two years following receipt of SBLF funding, the institution will be subject to an additional lending incentive fee of 2% per annum on the total amount of SBLF funding. For further reference regarding the material terms of the preferred stock investment relating to current CPP participants, please refer to [Summary of Terms for Current CPP Participants](#).

Treasury has clarified that participation in the SBLF is separate and distinct from its prior TARP CPP program. Participation in the SBLF carries *no* executive compensation restrictions and does not require the issuance of any warrants. Existing CPP participants that refinance under the program will, thereafter, no longer be subject to existing TARP executive compensation limitations. Treasury has been very clear that institutions will not, by virtue of participating in the SBLF, be considered a TARP recipient.

Underwriting Criteria. In conjunction with the SBLF, U.S. federal banking agencies released interagency guidance relating to [Underwriting Standards for Small Business Loans Originated Under the Small Business Lending Fund Program](#) that is designed to ensure that participating SBLF institutions extend credit in a safe and sound manner with prudent risk selection and credit risk management processes. This new guidance clearly states that participating institutions will have broad latitude in formulating the underwriting criteria in order to allow them to tailor their policies and products to meet the needs of their small business communities. Nevertheless, institutions should be cognizant of these underwriting standards as they consider the merits of participating in the SBLF program.

Summary. The items described above are only a few of the considerations of which you should be aware if your institution is considering participation in the SBLF. Although the SBLF is separate and distinct from TARP, it appears that the application and closing process will be very similar to the processes that were used by Treasury in connection with the CPP. Attorneys at our firm have represented dozens of institutions that have evaluated and/or participated in the CPP. Accordingly, we believe that we are uniquely qualified to assist institutions that are considering participation in this new program, particularly institutions that are thinking about refinancing an existing CPP investment. If you have questions about the material terms of participation in the SBLF or the application, approval or closing process as they apply to your particular institution, please do not hesitate to contact us.

© 2010 Fenimore, Kay & Harrison, LLP. This publication is provided by Fenimore, Kay & Harrison, LLP as a service to our clients and colleagues. The information contained in this publication should not be construed as legal advice and is not intended to create an attorney-client or similar relationship. Questions regarding the matters discussed in this publication may be directed to any of our lawyers listed above, or to any other lawyer in our firm with whom you have consulted in the past on similar matters. If you have not received this publication directly from us, you may obtain a copy of any past or future publications by visiting our website at www.fkhpartners.com and subscribing to the FKH Report.