



Audit Report



Report Number: OIG-SBLF-13-012

SMALL BUSINESS LENDING FUND: Reported SBLF Program Accomplishments Are Misleading Without Additional Reporting

August 29, 2013

Office of
Inspector General
Department of the Treasury

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Abbreviations

CDLF	Community Development Loan Fund
Lending survey	<i>Results of the First Annual SBLF Lending Survey</i>
OIG	Office of Inspector General
SBLF	Small Business Lending Fund
The Act	Small Business Jobs Act of 2010

*The Department of the Treasury
Office of Inspector General*

August 29, 2013

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Housing, and Community Development

This is the first of two audit reports on the use of capital provided to financial institutions participating in the Small Business Lending Fund (SBLF). SBLF was created in December 2010 to provide capital to community banks with assets of less than \$10 billion with incentives to stimulate small business lending. As of September 27, 2011, Treasury had invested \$4.03 billion in 332 institutions. This report addresses participant small business lending gains and progress in achieving small business lending plan projections. The second report will address how recipient institutions are using funds awarded under the SBLF program and the factors that most influenced their use of funds; participant plans for repayment of Treasury's investment and exit from the program; and Treasury's administration of the program.

The audit objectives for this report were to assess: (1) how current small business lending by SBLF recipient institutions compares to small business lending levels achieved prior to program entry; and (2) how current changes in small business lending compare to recipients' projections at the time of program application.

To accomplish our first objective, we evaluated changes in small business lending activity reported in Treasury's *Use of Funds Reports* through April 2013 to identify gains that were achieved prior to Treasury's investment of SBLF funds in participating institutions. We recalculated the reported lending gains by excluding lending that

occurred between December 31, 2009 (the midpoint of the SBLF baseline period), and September 30, 2011 (the end of the third quarter of 2011 when most participants received SBLF funding). We also interviewed Treasury officials to determine whether they isolated the impact of the SBLF funding on reported lending gains from other factors that affect small business lending, and reviewed prior Treasury OIG audit reports that addressed the accuracy of reported small business lending gains.

To accomplish our second objective, we reviewed the small business lending plans that participating institutions submitted when they applied for SBLF funds to identify lending gains that participants projected they would achieve in a period including 2 years following Treasury's investment. We also interviewed officials from a random sample of 100 participating institutions to determine whether they used a consistent time period for projecting their lending gains. We then compared their small business lending projections to actual lending gains reflected in Quarterly Reports submitted by 77 of those 100 institutions whose forecast periods were from the time of funding forward. We also reviewed Treasury's June 2013 report on its annual lending survey.¹

We conducted our fieldwork from October 2012 to July 2013 in accordance with *Government Auditing Standards*. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. Accordingly, we believe the evidence obtained to address our audit objectives provides a reasonable basis for our findings and conclusions. Appendix 1 contains a more detailed description of our audit objectives, scope, and methodology.

¹ U.S. Department of Treasury, *Results of the First Annual SBLF Lending Survey*, June 2013.

Results in Brief

In April 2013, Treasury reported that as of December 31, 2012, 320 institutions participating in SBLF had increased small business lending by \$8.9 billion. However, \$3.4 billion of the reported lending gains occurred prior to September 30, 2011, the quarter in which most participants received their SBLF funds.² The lending gains reported were measured against the same baseline period that the Small Business Jobs Act of 2010 (the Act) instructs Treasury to use for setting dividend rates for repayment of the SBLF capital, which is the four calendar quarters ended June 30, 2010. However, measuring program performance against a baseline with a midpoint 7 quarters prior to when most participants received funding inflates program accomplishments and is not responsive to provisions in the Act that direct Treasury to report on participant use of the SBLF funds received.

Treasury's April 2013 *Use of Funds Report* also characterizes the small business lending gains as being "widespread across SBLF participants," with 90 percent of participants increasing their small business lending over baseline levels. While this is true, it is important to note that half of the qualified lending increases reported were attributable to 35 (11 percent) of the 320 participants. The 35 participants were larger banking institutions in comparison to the other participants and had received larger SBLF capital injections.

Moreover, the direct impact that SBLF funds have had on the reported small business lending gains cannot be isolated from other factors. The lending gains reflected in Treasury's *Use of Funds Report* represent all small business lending gains that institutions participating in SBLF achieved, regardless of how the loans were funded. Because SBLF is a capital investment program, and not a direct lending program, capital invested is leveraged and not traced to individual loans. Bank accounting systems also do not link the

² Program records show that 316 institutions received SBLF funding in the quarter ended September 30, 2011, and 4 received their funding in the quarter ended June 30, 2011.

source of funds to loans made with them. Treasury officials told us that the *Use of Funds Report* indirectly measures the effect of SBLF funding by comparing business and other lending by SBLF banks to that of non-SBLF banks. However, these comparisons include pre-funding lending activity and are not a definitive measure of the use of SBLF funds.

In addition, prior audits by the Treasury OIG have shown that a large number of participants misreport their small business lending activity. In each of those audits, 50 percent or more of the institutions reviewed submitted erroneous lending data to Treasury, either overstating or understating their small business lending gains. While Treasury has a review process that catches certain types of reporting errors, and makes corrections to its reports as errors are detected, the Department would have to expand its review process to determine whether small business loans reported by participants have been correctly classified.

It is also difficult to measure participant progress in achieving their forecasted lending growth because the 100 participating institutions that we interviewed used different periods over which to make their projections, and 23 included loans made prior to SBLF funding. Nevertheless, we compared the progress of 77 financial institutions whose projection period was subsequent to funding, which showed that 43 (56 percent) of the 77 institutions were not on track to meet their growth projections by the end of their projection periods.

The remaining 34 participants had either exceeded or were on track to meet their forecasted growth. We recognize that Treasury never intended to use participant lending plans to measure program performance, but by not doing so, the Department has lost a valuable tool that could have been used to evaluate SBLF program outcomes.

Because the lending gains represented in the *Use of Funds Report* cannot be directly linked to the SBLF capital and Treasury cannot easily measure progress in achieving small business lending plans,

program impact cannot be determined. Also, the report does not disclose that some lending occurred prior to funding.

Finally, we noted that reported lending gains in Treasury's June 2013 report, *Results of the First Annual SBLF Lending Survey*, includes lending that occurred before SBLF funding and which cannot directly be linked to the SBLF capital. The accuracy of the report's discussion of participant progress in meeting lending projections is also questionable because our analysis showed that participants varied widely in how they projected their lending gains, rendering it difficult to track participant progress without individualized analysis.

Therefore, to provide greater transparency over representations made in its *Use of Funds Reports* to Congress and the *Results of the First Annual SBLF Lending Survey*, we recommend that Treasury revise the title of the *Use of Funds Report* to better reflect its contents; include in both reports only participant lending gains realized subsequent to SBLF funding; and disclose that such gains cannot be directly linked to the use of SBLF capital so that the information is not misinterpreted. We also recommend that when reporting the aggregate dollar increase in lending of participating institutions Treasury disclose whether the gains were concentrated among a few institutions or more widely distributed. Finally, we recommend that Treasury acknowledge in its 2013 *Lending Survey* report and in future reports that comparisons of projected to actual lending gains may differ from that presented because participants used different projection periods. Alternatively, Treasury may conduct an individualized analysis similar to that performed by the OIG to measure participant progress against projection periods cited in each participant lending plan.

Treasury accepted five of the six audit recommendations, but disagreed with recommendation 2, which would restrict the small business lending gains Treasury reports to just those realized subsequent to SBLF funding. The OIG considers Treasury's planned actions to be fully responsive to recommendations 1, 3, 4, and 5; and partially responsive to recommendations 2 and 6. Therefore, we

plan to pursue corrective actions for recommendations 2 and 6 through the audit resolution process.

In addition, Treasury disagreed with OIG's overall message that its *Use of Funds Report* is "misleading," primarily because counting lending gains realized before banks entered the SBLF program is consistent with how the Act directs Treasury to apply the program's financial incentives, and the Government Accountability Office (GAO) evaluated program lending gains using a methodology similar to Treasury's. However, we noted that the statutory language referenced by Treasury applies only to the calculation of dividend rates. Requirements for reporting on the use of funds are expressed in a separate provision of the Act that makes no reference to prior lending gains. Further, we confirmed with GAO that the scope of its review did not include assessing alternative baselines for measuring changes in the SBLF lending. The scope of its evaluation was strictly limited to reviewing lending activity reported by participants and the composition of the comparison group Treasury uses to evaluate SBLF.

Background

Enacted into law on September 27, 2010, the SBLF is a dedicated fund designed to encourage lending to small businesses by providing capital to qualified community banks³ and Community Development Loan Funds (CDLF). Treasury launched the SBLF program on December 20, 2010, and by the program's September 27, 2011, funding deadline had disbursed \$4.03 billion to 332 financial institutions. The 332 institutions included 281 community banks and 51 CDLFs.

Of the 281 community banks, 137 refinanced securities that had been issued to Treasury under the Capital Purchase Program with securities issued under SBLF. The Capital Purchase Program was one of Treasury's Troubled Asset Relief Program financial support

³ The terms "banks" and "community banks" encompass banks, thrifts, and bank and thrift holding companies with consolidated assets of less than \$10 billion.

programs in which Treasury directly purchased preferred stock or subordinated debentures in qualifying financial institutions. As of the April 2013 *Use of Funds Report*, 12 institutions had fully redeemed their SBLF securities and exited the program, leaving a total of 320 SBLF participants. As part of the application process, SBLF applicants were required to submit a small business lending plan to their primary Federal or state regulator in addition to the SBLF application sent to Treasury. The plan included (1) a description of how participation in SBLF would enable the institution to better address small business needs, (2) the institution's projected increase in small business lending, and (3) the institution's approach to community outreach.

Treasury requires each SBLF participant to submit *Quarterly Supplemental Reports* indicating changes in small business lending activity. The Act defines "small business lending" as business loans that are \$10 million or less to businesses with \$50 million or less in annual revenue. Business loans comprise: commercial and industrial loans; loans secured by owner-occupied nonfarm, nonresidential properties; loans to finance agricultural production and other loans to farmers; or loans secured by farmland.

Changes in small business lending are calculated as the difference between the amount of loans outstanding each quarter and the average amount outstanding in the four quarters ending June 30, 2010 (the baseline period).⁴ There are additional adjustments to the calculation of small business lending relating to net charge-offs and portions of loans guaranteed by the U.S. government or loans for which the risk is assumed by third parties, as well as mergers, acquisitions, and purchases of loans.

The Act requires Treasury to report quarterly on how institutions participating in SBLF used the funds they received. In response to this requirement, Treasury issues a quarterly *Use of Funds Report* to

⁴ The Act defines the baseline period as "the 4 full quarters immediately preceding the date of enactment of this Act," which comprises the quarters that end September 30, 2009 through June 30, 2010.

Congress. The report documents changes in small business lending relative to baseline levels for SBLF institutions and compares lending by SBLF banks to non-SBLF bank groups.

Small Business Lending Gains Reported by Treasury are Significantly Overstated and Cannot Be Linked Directly to SBLF Funding

In its quarterly reports to Congress on the SBLF program, Treasury has consistently reported that institutions participating in SBLF have made important progress in increasing their small business lending. For example, Treasury's April 2013 *Use of Funds Report* shows that as of December 31, 2012, participants increased their small business lending by \$8.9 billion (or 24.1 percent) over a \$36.9 billion baseline.⁵

Treasury also reported that 90 percent of SBLF participants increased their small business lending, and that 83 percent increased their qualified small business lending by 10 percent or more, which is generally the program's incentive level for achieving the lowest dividend or interest rate on the SBLF capital.

While the lending activity reported appears impressive, not all of the lending gains are associated with SBLF funding. Substantial amounts of the reported gains occurred prior to participants receiving SBLF funding, and the gains cannot be directly linked to the SBLF capital that Treasury invested in the financial institutions. Also a small number of institutions are responsible for half of the lending gains.

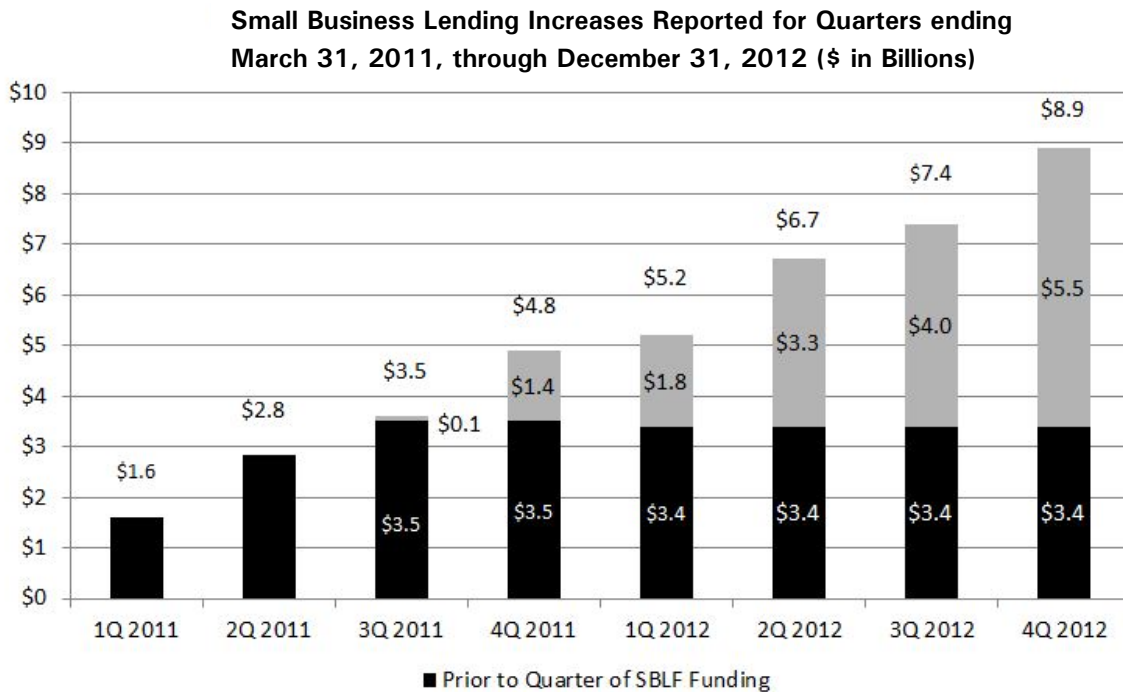
Finally, prior Treasury OIG audit reports have disclosed that over 50 percent of institutions either under- or over-reported their small business lending activity. For example, one audit found that 80 percent of institutions reviewed inaccurately reported their small

⁵ The baseline can fluctuate each quarter as SBLF participants must adjust their baselines for "increases in qualified loan balances resulting from mergers, acquisitions, and/or purchases of such loans" from July 1, 2010, through the reporting period.

business lending gains, with errors totaling \$74 million. Therefore, Treasury's *Use of Funds Report* does not present an accurate picture of the impact that SBLF funding has had on institution small business lending activity.

One-Third of Reported Gains Occurred Prior to SBLF Funding

Of the \$8.9 billion in small business lending gains reported in Treasury's April 2013 *Use of Funds Report* to Congress, \$3.4 billion (39 percent) occurred prior to most participants receiving SBLF funding. The \$3.4 billion in gains occurred during the 7 quarters between December 31, 2009 and September 30, 2011, the end of the quarter in which all but four participants received their SBLF funding. The remaining \$5.5 billion, or 61 percent, occurred between October 1, 2011, and December 31, 2012, which was after Treasury disbursed the SBLF capital to participants. Quarterly increases in small business lending activity are illustrated below.



Source: OIG analysis of SBLF *Quarterly Supplemental Report* data. Subtotals in the bars may not add up to the summary totals above the bars because of rounding.

Additionally, the April 2013 *Use of Funds Report* states that 83 percent of SBLF participants had increased their small business lending by 10 percent or more. However, not all of these gains were

achieved with the SBLF capital, as one-third of the gains occurred prior to September 30, 2011, the end of the quarter when most institutions received their SBLF funds.⁶ Only 64 percent of SBLF participants had increased their small business lending by 10 percent or more between October 1, 2011, and December 31, 2012, which is the period of activity that Treasury should have reported.

The baseline period used by Treasury to measure lending performance was established by the Act for purposes of calculating the dividend rates on securities invested in institutions participating in SBLF. To incentivize SBLF participants to lend to small businesses, the Act provides that institutions will pay dividends to Treasury at rates that decrease as the amount of the institutions' small business lending increases. In its June 2011 *Getting Started Guide*, Treasury acknowledged that institutions would get credit for small business lending gains achieved prior to SBLF program entry and that those gains could help institutions qualify for lower dividend rates.

Although the Act established the baseline period as a metric to be used for setting dividend rates, it is not an appropriate measure for reporting on program performance because the baseline ended on June 30, 2010, with a midpoint 7 quarters before most participants received funding. Moreover, the Act does not instruct Treasury to use the baseline period for measuring and reporting on the uses of funds. The Act clearly states that Treasury must report on how participants in the SBLF program have used the funds received under the program. Therefore, reporting lending activity that occurred prior to Treasury's investment in institutions distorts program

⁶ We classified most of the lending activity in the third quarter of 2011 as occurring prior to SBLF funding because a high percentage of participants received approval and/or funding too late in the third quarter to make loans with the SBLF funds. Specifically, 57 percent of participants did not receive preliminary approval until August or September 2011; and 61 percent did not receive SBLF funding until September 2011, of which 40 percent received funding in the last 2 weeks of that month. Given the high number of institutions funded late in the quarter, the 29-day average period between preliminary approval and funding, and loan processing times, we concluded that most of the lending activity reported for the third quarter of 2011 was associated with capital that banks had before entering the SBLF program.

accomplishments and is not responsive to the reporting directive in the Act.

Treasury's April 2013 *Use of Funds Report* also characterized small business lending increases as being widespread across participants. Treasury reported that as of December 31, 2012, 288, or 90 percent of participants, increased their small business lending over baseline levels, and 83 percent increased their small business lending by 10 percent or more. While these gains were widespread, a relatively small number (35, or 11 percent) of SBLF participants accounted for half of small business lending increases between the baseline period and December 31, 2012. Generally, the 35 participants that accounted for half of small business lending increases were larger in comparison to the other banking institutions and had received larger SBLF capital injections.⁷

We believe that the distribution of small business lending gains should be measured from the time of funding forward, and not against the baseline period as Treasury has done. When measuring the lending gains in this way, 272 out of the 320 participants, or 85 percent, had increased their small business lending by a net of \$5.5 billion from the time SBLF funds were received. By including qualified lending that occurred prior to when participants received their funding, Treasury's April 2013 *Use of Funds Report* significantly overstated the impact that the SBLF capital had on the small business lending of institutions participating in the SBLF program.

The Direct Impact of SBLF Funds on Small Business Lending Gains Cannot Be Determined

As previously stated, the effect that SBLF funding has had on the small business lending gains realized by SBLF institutions cannot be isolated from other factors. Treasury requires that participating institutions report all qualified small business lending activity each quarter, regardless of whether the lending is directly linked to the

⁷ Of the 35 banking institutions, 24 (or 69 percent) had total assets and SBLF capital that ranked in the 75th to the 100th percentile among all banking participants.

SBLF capital provided by Treasury. As a result, Treasury's quarterly *Use of Funds Report* reflects all qualified small business lending gains achieved by each participant, and thus does not provide a measure of program impact.

According to Treasury officials, there are several reasons why the direct impact of the SBLF capital on lending gains cannot be measured. First, SBLF is a capital investment program, and not a direct loan program in which every dollar loaned can be linked to the source of capital. Under the SBLF program, capital was invested in participating institutions through the purchase of senior preferred stock or equivalents. Participants were expected, but not required, to leverage their SBLF capital to increase small business lending, and are eligible to pay reduced dividend rates as their small business lending increases. Therefore, by design, participating institutions were given latitude in deciding how to use their SBLF capital.

Secondly, Treasury officials stated that double entry accounting systems used by participating institutions do not provide a way to trace the SBLF capital that institutions received to individual loans made with that capital. Under double entry accounting, the receipt of SBLF capital generally increases a bank's equity, and issuing loans increases assets. Therefore, capital invested is not associated with particular loans, and the SBLF capital loses its identity once provided to a participating institution.

Treasury officials stated that for these reasons, it does not require participants to track their use of funds, and instead measures the effect of SBLF capital on lending using the lending gain measures prescribed by the Act for establishing program dividend rates. The gains are measured quarterly by comparing each institution's current lending to lending levels from a baseline period seven quarters before most participants received SBLF funding. Treasury officials told us that they also measure program impact by comparing SBLF institution lending performance to that of institutions that did not receive SBLF funding. These comparison analyses, however, show only the relative progress of SBLF banks compared to non-SBLF banks, are not a definitive measure of the use of SBLF funds, and

include lending activity made prior to participants joining the SBLF program.

Because Treasury cannot isolate the impact that the SBLF capital has had on lending reported by SBLF participants, policy makers, including the Congress, may not have the information needed to assess whether the SBLF program has been effective. However, Treasury's *Use of Funds Report* discloses the small business lending gains as if they are all directly linked and solely attributable to the SBLF funding. Therefore, to avoid a misinterpretation of its report, Treasury will need to disclose that reported small business lending gains cannot be directly linked to the use of SBLF funds and that some of it pre-dates SBLF funding.

Treasury OIG Audits Have Disclosed a Significant Number of Errors in the Reporting of Small Business Lending Gains

Three prior Treasury OIG audits determined that a significant number of SBLF participant banks made errors in the small business lending increases they reported quarterly to Treasury.⁸ Treasury uses the information reported by participants to prepare its quarterly *Use of Funds Report* on program accomplishments. Because participant reports are used for both setting dividend rates and reporting program accomplishments, the objective of these audits was to determine the accuracy of qualified small business lending increases reported by SBLF participants. Of the 51 banks reviewed in the 3 audits, 73 percent, or 37 institutions, submitted inaccurate lending data to Treasury.

The first report, dated August 21, 2012, disclosed that 80 percent of the institutions reviewed inaccurately reported their small business lending gains, with errors totaling \$74 million.⁹ The second report, dated January 29, 2013, showed that 53 percent of lending institutions reviewed misreported their lending activity, with

⁸ The three audits did not cover CDLFs.

⁹ Report No. OIG-SBLF-12-005, *Small Business Lending Fund: Initial Dividend Rate Calculations Used Incorrect Lending Information*.

reporting errors totaling over \$78 million.¹⁰ In the third report, dated August 9, 2013, 86 percent of the institutions reviewed inaccurately reported their lending gains, with reporting errors totaling approximately \$17.7 million.¹¹

The errors included both over- and under-reporting of lending gains and were largely caused by SBLF participants: (1) incorrectly classifying loans as small business loans; (2) incorrectly recording Call Report loan volumes; and (3) improperly adjusting lending volumes. These errors resulted in both under- and over-statements of small business lending gains by SBLF participants that were reported to Congress in Treasury's quarterly *Use of Funds Reports*.

While Treasury promptly corrected the errors identified by the audits and has a review process that detects some recording and adjustment errors, its current procedures cannot determine whether small business loans reported by participants on their Call Reports are accurately classified. Classification errors can be identified only by reviewing an institution's loan records to determine the appropriate Call Report loan category in which to report the loan balance. Call Reports are filed with an institution's regulator, and used by the regulator to determine the safety and soundness of institutions and whether they are meeting their capital requirements, among other purposes.

Progress in Meeting Lending Plan Projections is Difficult to Measure

Institutions that applied to the SBLF program submitted small business lending plans that in aggregate forecast \$9.3 billion in small business lending growth 2 years following Treasury's investment.¹² Treasury intended that the projections cover the period from the

¹⁰ Report No. OIG-SBLF-13-004, *Small Business Lending Fund: Accuracy of Third-Quarter 2012 Dividend Rate Adjustments*.

¹¹ Report No. OIG-SBLF-13-010, *Small Business Lending Fund: Accuracy of Fourth-Quarter 2012 Dividend Rate Adjustments*. The total amount of errors is rounded up from \$17,690,987.

¹² The 2 years ended June 30, 2013, for 4 institutions, and ends September 30, 2013, for all others.

baseline, before funding occurred, to 2 years following Treasury's investment in each institution. However, our review of 100 lending plans disclosed that it is difficult to measure participants' progress in meeting their forecasted growth, because participants used different periods over which to make their projections and many included loans made prior to funding.

The 100 institutions that we reviewed used 5 different periods for their lending projections; 89 projected over 8 quarters, 8 projected over 15 quarters as Treasury intended, and 3 used other, unique projection periods. The starting date for the projection periods also varied. Ten used a date during the baseline period, 72 used a date during the quarter they received funding, 13 used a date that was before the quarter of funding *and* was not in the baseline period, and 5 used a date that was after the quarter of funding.

Therefore, to accurately measure actual lending against the forecasts, one would have to individually match the forecast period to the actual lending for the same period. Treasury intended that the participants' forecasts include the period from the baseline to funding, but most of the participants in our sample (77 out of 100) did not include this period in their forecasts. By comparing this longer actual results period of gains to banks' shorter projection period, Treasury overstated participant progress toward their projected lending levels.

Participants' misunderstanding of Treasury's directions resulted from Treasury's referral to multiple documents for guidance and unclear language. For example, Treasury's Lending Plan Form asked applicants to "estimate the dollar amount of the increase in qualified small business lending, as defined for purposes of the Small Business Lending Fund, that your institution projects achieving two years following Treasury's investment." Treasury's guidance then referred applicants to a separate document for the meaning of the phrase "as defined for purposes of the Small Business Lending Fund." Treasury's summary of terms states that the change in qualified lending is measured from the SBLF baseline.

Additionally, 23¹³ of the 100 institutions we interviewed included lending in their forecasts that occurred before they received SBLF funding, while 77 did their forecasts from the time they received SBLF funding forward, which is the only valid period in which to measure lending activity generated by the program. Treasury officials told us that they did not intend that the lending plans serve as a measure of program success or as “goals” because the Act provides an incentive structure separate from the lending plan. In addition, Treasury officials stated that lending performance was not part of the statutory requirements for the lending plan. Rather than requiring a certain amount of small business lending, the statute set up an incentive structure for participants to decrease their cost of capital if they increased the amount of small business loans they made.

Treasury told us that the statute did not provide for the lending plan projections to serve as program goals; however, we believe that tracking and publicly reporting participants’ progress toward fulfilling their projections could have served as a way to measure program performance. This missed opportunity takes on added importance in light of the fact that Treasury lacks a means to track the direct impact that the SBLF capital had on participants’ reported lending gains.

Over Half of Participants that Limited their Forecasts to the Post Funding Period are Not On Pace to Meet Projections

A comparison of the forecasted growth for the 77 institutions to the gains they reported over the post-funding period showed that 43 (or 56 percent) were not on track to meet their growth projections by the end of the projection period. Of the 43 that were not on track, 44 percent (or 19) were former Troubled Asset Relief Program institutions. The average amount of growth in qualified lending that would be needed for the 43 institutions to meet their projections

¹³ The 23 included 10 institutions that started their projections from the SBLF baseline and 13 that started their projections from a date before the quarter they received SBLF funds, but not in the baseline period.

was 91 percent, and ranged from 38 percent to 219 percent for individual institutions.

Of the remaining 34 institutions, 23 have already increased their small business lending up to their forecasted levels, and 11 are on pace to meet their forecasted growth by the end of their projection periods.

Treasury's Own Lending Survey Report Repeats Problematic Statements from the *Use of Funds Reports* about Lending Gains

Treasury's June 2013 report, *Results of the First Annual SBLF Lending Survey*, includes statements similar to those we found in the *Use of Funds Reports* that could be misleading without more discussion about what the information represents. For example, the survey report repeats a statement from the April 2013 *Use of Funds Report* that "SBLF participants have increased their small business lending by \$8.9 billion," without disclosing that the gains include lending made prior to Treasury's investment and are not limited to lending tied directly to SBLF capital.

We also have concerns that the survey report's discussion of participants' original and updated lending projections may be inaccurate. As discussed previously, our analysis of 100 participants' lending projections showed that institutions interpreted Treasury's instructions differently and used different time periods for their projections, rendering it difficult to track participant progress against their projections without individualized analysis. Because Treasury has not performed such an analysis, the accuracy of the survey report's statement that "of the current SBLF participants, more than 50 percent have already increased their small business lending by more than their original two-year projection" is questionable. Finally, Treasury reported that participants will increase lending by more than they had initially planned or by \$10.3 billion over baseline levels,¹⁴ which also may not be accurate

¹⁴ The projected \$10.3 billion in lending gains is up from the \$9.3 billion original aggregate lending projection.

given that participants used different time periods for their projections.

Conclusions

There is no single definitive or accurate means of measuring the impact that the SBLF program has had on increasing small business lending. Although participating institutions submit quarterly reports to Treasury on their small business lending activity, the reported activity includes loans made prior to Treasury's investment and is not limited to loans made with SBLF funds. Treasury has never asked participating institutions for an accounting of how they used the funds provided under the program. Yet, Treasury has relied on the quarterly reports from participating institutions to inform Congress and the public on how funds provided under the program were used. Moreover, titling the report "Use of Funds" gives the wrong impression that all reported lending activity was financed with SBLF capital and occurred after Treasury's investment.

Finally, by not using the lending plan projections to measure program performance, Treasury lost what could have been a valuable tool to evaluate SBLF program outcomes. We understand that Treasury did not want to set the lending plan projections as "goals" because the Act provides an incentive structure separate from the lending plan. However, best practices for results-oriented organizations are to define goals and desired outcomes, set overall and incremental measurable targets to gauge progress, and use performance information as a basis for decision-making.

Recommendations

To provide greater transparency over program accomplishments, we recommend that the Deputy Assistant Secretary for Small Business, Housing, and Community Development:

1. Revise the title of the *Use of Funds Report* to more accurately reflect the report's contents.
2. Report only those small business lending gains in the *Use of Funds Report* that were realized after SBLF funding.

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3. Disclose that reported small business lending gains cannot be directly linked to the use of SBLF funds.
 4. Disclose whether gains were concentrated among a few institutions or more widely distributed when reporting the aggregate dollar increase in lending of participating institutions.
 5. Ensure that recommended changes made to the *Use of Funds Report* are reflected in the 2013 *Results of the First Annual SBLF Lending Survey* report.
 6. Amend the 2013 *Results of the First Annual SBLF Lending Survey* report to acknowledge that a comparison of projected and actual increases in small business lending may differ from that reported due to variances in projection periods used by participants; and either make the same disclosure in future survey reports or perform an individualized analysis to measure actual progress by participants.

Management Response and OIG Comments

We provided a draft of this report to Treasury on July 22, 2013. On August 5, 2013, we received formal written comments. Treasury agreed with all but the second recommendation and proposed actions that were fully responsive to all recommendations, except Recommendations 2 and 6. Management's comments and the OIG's response are summarized below by each recommendation. Treasury's response is included in its entirety in Appendix 2.

1. Revise the title of the *Use of Funds Report* to more accurately reflect the report's contents.

Management Response

Treasury agreed to revise the title of the *Use of Funds Report* to more accurately describe the report's contents.

OIG Comments

We consider Treasury's planned action to be responsive to our recommendation.

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2. Report only those small business lending gains in the *Use of Funds Report* that were realized after SBLF funding.

Management Response

Treasury did not agree to limit its reporting to post-funding gains, and plans to continue to report lending gains relative to the baseline as it did in its July 2013 *Use of Funds Report*. Treasury stated that limiting the reporting of gains to only those realized subsequent to SBLF funding would reduce transparency and create inconsistencies between how Treasury measures gains for reporting and for calculating dividend rates.

OIG Comments

We did not find management's plan to continue its current practice of reporting small business lending gains to be responsive to Recommendation 2. The *Use of Funds Report*, as currently constructed, prominently reports the total increase in qualified small business lending against the baseline period - a comparison that our analysis shows is not an accurate measure of program impact because it includes 7 quarters of gains that occurred prior to when most participants received their SBLF capital. Our audit disclosed that 39 percent of the lending gains Treasury attributed to the SBLF program were made before most of the institutions received SBLF funds, and consequently were not an outcome or result of the SBLF funding. Therefore, prominently reporting these gains as if they are program accomplishments is misleading and does not provide the transparency needed to determine program impact.

The *Use of Funds Report* also includes a graph showing lending gains by quarter. However, a reader would have to know in which quarter SBLF participants received the SBLF capital to identify how much of the reported gains occurred subsequent to funding. Treasury needs to differentiate between lending performance before funding, which should be used only to assess dividend rates, and lending performance after funding. We note that in its July 2013 report,

Treasury attempted to differentiate between the two, but the information was buried in Appendix B. However, the appendix inappropriately designated all lending gains that occurred during the third quarter of 2011 as “post-funding,” even though many banks received their funding too late in the quarter to make loans from the SBLF capital.

Additionally, we disagree with Treasury’s assertion that the reporting of lending gains should be consistent with how the Act directs Treasury to apply the program’s financial incentives. The Act requires that the baseline period, which occurred 7 quarters prior to SBLF funding, be used for calculating dividends and interest rates, and not for measuring SBLF program performance. Requirements for reporting on the “use of funds” are expressed in a separate provision of the Act that makes no reference to prior lending gains or measurement of gains against the baseline period. Nevertheless, lending gains realized prior to receipt of the SBLF capital do not constitute a “use of funds” because most participants did not receive the SBLF funds until late in the third quarter of 2011, or 7 quarters after the baseline period.

As a result, we plan to pursue a more responsive action from Treasury through the audit resolution process.

3. Disclose that reported small business lending gains cannot be directly linked to the use of SBLF funds.

Management Response

Treasury agreed to include a specific statement in its reports disclosing that program performance can be measured only indirectly, and that lending gains cannot be linked directly to SBLF funds. Treasury also stated that the audit report asserts that the “direct impact of SBLF funds on small business lending gains cannot be determined,” but does not mention that the program’s indirect impact on lending can, and is, being measured.

OIG Comments

We consider Treasury's planned action to be responsive to our recommendation. Like GAO, we believe that Treasury remains challenged to find an approach that isolates the impact of SBLF relative to other factors that affect participant small business lending. Disclosing that reported small business lending gains cannot be directly linked to the use of SBLF funds is an important transparency step that Treasury can take immediately while it assesses other measurement methods for the SBLF program.

We did not comment on or endorse Treasury's indirect method of measuring program outcomes because we did not evaluate the accuracy of Treasury's method, and as Treasury acknowledged, it is not possible to adjust for all factors that contribute to lending performance using a peer or comparison group analysis. Also, GAO reported that the transparency of Treasury's indirect method of measuring program outcomes was compromised because it did not explain why the larger comparison group was chosen for analysis or why other adjustments to the comparison groups were not made.

4. Disclose whether gains were concentrated among a few institutions or more widely distributed when reporting the aggregate dollar increase in lending of participating institutions.

Management Response

Treasury agreed to disclose the distribution of small business lending gains on a dollar basis in future reports.

OIG Comments

We consider Treasury's planned action to be responsive to our recommendation.

5. Ensure that recommended changes made to the *Use of Funds Report* are reflected in the 2013 *Results of the First Annual SBLF Lending Survey* report.

Management Response

Treasury agreed to update its 2013 lending survey report to disclose that small business lending gains cannot be linked to SBLF funds, and will include in future publications an analysis of lending gains that were realized after SBLF funding.

OIG Comments

We consider Treasury's planned actions to be responsive to our recommendation.

6. Amend the 2013 *Results of the First Annual SBLF Lending Survey* report to acknowledge that a comparison of projected and actual increases in small business lending may differ from that reported due to variances in projection periods used by participants; and either make the same disclosure in future survey reports or perform an individualized analysis to measure actual progress by participants.

Management Response

Treasury stated it will update its 2013 lending survey report to reiterate that projected and actual increases in small business lending may differ from that reported, and noted that the report already acknowledges the potential for variances.

OIG Comments

While Treasury agreed with Recommendation 6, its proposed actions were not fully responsive because its *Annual SBLF Lending Survey* report acknowledges only idiosyncratic variability in the survey results. We believe that variances in participants' projection periods are not idiosyncratic, and render Treasury's existing comparison of projected and actual lending gains inaccurate, and therefore, meaningless. Treasury cannot compare actual gains with lending forecasts unless it does an individualized analysis of each institution using the projection period each institution employed. If Treasury does not perform such an analysis, it will effectively overstate

participant progress in meeting projected lending levels, and therefore, Treasury needs to disclose the variances and the impact they have on reported lending gains.

Treasury did not indicate whether it would modify future surveys to communicate the variability in lending plan periods or perform an individualized analysis to measure actual progress by participants. As a result, we plan to pursue a more responsive action from Treasury through the audit resolution process.

Management Comment 1

Management asserted that the report characterizes Treasury's reporting as "misleading"; however, Treasury's reporting mirrors the methodology used by GAO in its most recent report on SBLF: Government Accountability Office, *Small Business Lending: Opportunities Exist to Improve Performance Reporting of Treasury's Programs*, GAO-13-76, (December 5, 2012).

OIG Response

We believe that Treasury has misconstrued GAO's reporting as an endorsement of its methodology for calculating small business lending gains. We consulted with GAO officials responsible for reporting on the SBLF program, who confirmed that their December 2012 report did not evaluate whether Treasury's use of the baseline period was appropriate for measuring small business lending gains. As shown in Appendix I of GAO's report, to determine how Treasury measures program outcomes, GAO evaluated only the methodology that Treasury used to assess the performance of SBLF participants against a comparison group of institutions that did not participate in SBLF. Therefore, GAO's scope was limited to understanding the process for developing the comparison group, and replicating that group for analysis.

Contrary to what Treasury believes, GAO remains concerned that Treasury has not done enough to identify performance measures that isolate the impact of SBLF funding and that more transparency is

needed in the SBLF information reported. GAO's 2012 report concludes that "As we found in our December 2011 SBLF report, Treasury has yet to finalize plans for assessing the performance of the program, including measures that can isolate the impact of SBLF from other factors that affect small business lending." The report also states that "...a more transparent description of the methodological decisions would help to enhance the transparency of the information reported."

Management Comment 4¹⁵

Management commented that the OIG report does not disclose that the errors detected by prior OIG audits totaled less than 0.1 percent of small business lending reported by all participants.

OIG Response

We do not believe that Treasury understands that our audit results represent the value of dollar errors identified in the statistical samples we evaluated, and are not an estimate of all potential errors in the total lending gains reported. As with any representative sample, if the results are extrapolated to the entire population, the estimated error would be considerably larger. While our audit reports did not extrapolate the sample results to the total lending gains reported, we maintain that the overall dollar value of errors in lending gains reported by participants is considerably larger than what we reported.

Management Comment 5

Management stated that OIG's analysis of SBLF participants' lending plans misconstrues their contents and its misguided critique of Treasury's approach comes over 2½ years after the fact.

¹⁵ We have not included separate OIG responses to Treasury's Comments 2 and 3 because the subjects of the comments are discussed with management's responses to recommendations.

OIG Response

Treasury continues to compare participant projections of varying lengths and starting points to actual lending performance over a generally longer, single fixed period. We remain concerned that Treasury did not detect that most SBLF participants misunderstood its instructions for creating the lending plan and, as a result, used different time periods of varying lengths for their lending projections. However, Treasury continues to compare the lending plan projections in aggregate with actual lending performance – a comparison we believe cannot be accurate or meaningful given that actual projection periods varied widely.

Further, we understand that Treasury never intended to use the lending plan projections to measure individual participant performance. However, contrary to what Treasury's original intentions were, the Department has used the plans to measure and report on program performance. In June 2013, Treasury issued a report entitled, *Results of the First Annual SBLF Lending Survey*, declaring that SBLF participants expect to increase small business lending by \$10.3 billion within 2 years of receiving Treasury's investment, which represents an increase from the \$9.3 billion aggregate estimate that participants provided on lending plans submitted during the application process.

The report further states that "Of the current SBLF participants, more than 50 percent have already increased their small business lending by more than their original two-year projection. An additional 23 percent were more than halfway to achieving their lending projections, while the remaining 23 percent were less than halfway." Therefore, Treasury's comment is inconsistent with its actions. We also believe our critique of Treasury's use of the lending plans is timely. Since Treasury did not report on participant progress in meeting lending plans until June 2013, it would not have been possible for the OIG to have commented on it 2½ years ago.

* * * * *

We appreciate the courtesies and cooperation provided to our staff during the evaluation. If you wish to discuss the report, you may contact me at (202) 622-1090, or Clayton Boyce, Audit Director, at (202) 927-5642.

/s/

Debra Ritt

Special Deputy Inspector General for

Office of Small Business Lending Fund Program Oversight

Appendix 1: Objective, Scope, and Methodology

The objectives of the audit were to determine: (1) how current small business lending by Small Business Lending Fund (SBLF) recipient institutions compares to small business lending levels achieved prior to program entry; and (2) how current changes in small business lending compare to recipients' projections at the time of program application.

The scope of our audit focused on the 320 institutions that continued to participate in the program as of March 13, 2013. Of the 332 institutions that originally participated in the SBLF program, 12 repaid their SBLF investment and exited the program. The scope also covered the time period from the SBLF baseline, the four quarters ending June 30, 2010, to the latest quarter data available for program participants, which ended December 31, 2012, and was in the April 3, 2013, *Use of Funds Report*.

To accomplish our first objective, we reviewed our prior audits on the accuracy of reported small business lending gains. We evaluated changes in small business lending activity reported in Treasury's *Use of Funds Reports* through April 2013 to identify small business lending gains that were achieved prior to Treasury's investment of SBLF funds in participating institutions (*i.e.*, from the midpoint of the SBLF baseline, December 31, 2009, and the end of the third quarter 2011, September 30, 2011, when most participants received SBLF funding.) We also interviewed Treasury officials on the extent to which Treasury measures and isolates the impact of the SBLF funding on reported lending gains from other factors that affect small business lending.

To accomplish our second objective, we reviewed the small business lending plans that participating institutions submitted when they applied for SBLF funds to identify lending goals that participants projected they would achieve in a period that included the 2 years following Treasury's investment. We also interviewed officials from a random sample of 100 participating institutions to determine whether they used a consistent period of time for projecting their lending gains. We then compared their small business lending projections to actual lending gains reflected in Quarterly Reports submitted by the 100 institutions for the specific time periods upon which their projections were based.

Finally, we calculated increases in small business lending for every dollar of SBLF funding for 77 of 100 participants institutions we sampled that included only lending since funding in their projections. In addition, we reviewed Treasury's June 2013 *Results of the First Annual SBLF Lending Survey* report.

We conducted our audit from October 2012 to July 2013 in Washington, D.C., in accordance with *Government Auditing Standards*. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained to address our audit objective provides a reasonable basis for our findings and conclusions.

Appendix 2: Management Response



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

August 5, 2013

Debra Ritt
Special Deputy Inspector General for
Office of Small Business Lending Fund Program Oversight
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Ms. Ritt:

Thank you for the opportunity to review your draft report (the Report) assessing the Small Business Lending Fund (SBLF) program's reporting. Treasury values the contributions of the Office of the Inspector General (OIG) to the SBLF program. This letter provides Treasury's official response.

Treasury takes its responsibility to report accurately on the results of the SBLF program very seriously. We strongly disagree with several of the Report's statements and conclusions. Treasury's reporting is consistent with its statutory mandate, the structure of the SBLF program as designed by Congress in the Small Business Jobs Act of 2010 (the Act), and our review of best practices for government program assessment.

The SBLF program has been a success. In the six quarters following funding, SBLF institutions have increased small business lending by \$9.0 billion over the baseline level set by Congress in the Act.

The Report asserts that Treasury should use a different reporting methodology and discontinue use of its current approach. It is important to note that SBLF participants have succeeded in substantially increasing small business lending when evaluated by the Report's alternative approach – with 85 percent of institutions reporting lending increases, 63 percent reporting increases of 10 percent or more, and an overall median lending increase totaling 15 percent.

Treasury believes OIG's suggested approach would create significant reporting deficiencies if used, as the Report recommends, as the "only" reporting methodology. However, this approach can provide additional information, and Treasury has included similar data in its prior reporting and added further detail starting with the *July 2013 Use of Funds Report*.

The following responds to specific statements and conclusions in the Report:

- 1. The Report characterizes Treasury's reporting as "misleading"; however, Treasury's reporting mirrors the methodology used by the Government Accountability Office (GAO) in its most recent report on SBLF.**

In December 2012, GAO published a year-long study of Treasury’s SBLF program reporting, concluding that “SBLF participants have generally increased their levels of both small business and total business lending.”¹ Treasury’s reporting methodology since January 2013—including that used in the *April 2013 Use of Funds Report* that the audit references—substantively mirrors the methodology employed by GAO in its assessment.

OIG critiques Treasury for reporting lending results using the baseline period established by Congress, claiming that this approach “overstates” lending gains. GAO, however, used the same baseline period as Treasury in its analysis, stating in its report that it “calculated the baseline using the average of the four quarters ending June 30, 2010.”² OIG asserts that this methodology “distorts program accomplishments,” and characterizes Treasury’s reporting as “misleading.” By implication, OIG’s assertion suggests that GAO’s reporting is also misleading.

Further, GAO’s report offered several helpful recommendations; however, GAO did not recommend making a change to the reporting methodology using the baseline set forth in the statute.

2. OIG’s proposed limited reporting would disregard the dividend rate incentives that Congress established and would yield significant deficiencies in reporting.

The Report recommends that Treasury report “only” on “participant lending gains realized subsequent to SBLF funding.” Treasury does not agree that OIG’s proposed methodology should be the “only” reporting methodology.

Congress established the baseline period—i.e., the four quarters ended June 30, 2010—as the means for measuring changes in small business lending and implementing the program’s financial incentives. By law, Treasury provides financial incentives to institutions for small business lending increases using the baseline period established by Congress. Treasury also reports lending increases on this basis. The Report claims a comparison to the baseline period is not appropriate for measuring program performance.

OIG’s recommendation does not consider the implications of its proposed approach with respect to transparency and consistency in program reporting.

First, OIG’s approach does not account for the incentives Congress provided for banks to increase their small business lending prior to receiving SBLF funding. Many banks increased lending prior to receiving SBLF funding, which qualified them for a better dividend rate. Because Congress established the baseline as a period prior to SBLF’s enactment—and permitted institutions to include lending increases achieved between that period and the investment date to count toward receiving the dividend rate incentives—banks had a compelling motivation to accelerate their lending before receiving the SBLF funding, thereby advancing the economic recovery during a challenging time. Indeed, Treasury highlighted this feature of the program’s design in its outreach to banks during the application period. OIG’s proposed

¹ Government Accountability Office, “Small Business Lending: Opportunities Exist to Improve Performance Reporting of Treasury’s Programs” (December 5, 2012), page 17.

² *Ibid.*, page 47.

methodology minimizes or excludes the lending gains of the institutions that used this incentive to rapidly increase their lending.

Second, OIG's proposed approach of using a different measurement period for reporting than for calculating the dividend rate would result in Treasury financially compensating institutions on one basis and reporting to Congress and the public on another. This inconsistent approach would leave Treasury open to criticism.

Third, OIG's approach, in isolation, would obscure the cost of SBLF's economic incentives to the taxpayer by making Treasury's financial gains appear artificially inflated. The lending increases reported using OIG's methodology would be smaller than the lending increases the law requires Treasury to use when calculating the dividend rate. These smaller lending increases would imply that Treasury receives higher dividends from participants than Treasury actually receives.

Treasury believes that evaluating lending before and after receipt of SBLF funding provides useful data for further assessment. For this reason, each Use of Funds report has clearly shown the increase in lending from the baseline period through the second or third quarter of 2011, the quarters institutions received SBLF funding. In addition, Treasury's *July 2013 Use of Funds Report*, which was not part of this audit, expanded this analysis to provide additional detail regarding increases in business lending since second quarter 2011 (the quarter immediately prior to the receipt of SBLF funding by most participants) by institution size, geography, financial condition, and loan type.

3. The Report asserts that the “direct impact of SBLF funds on small business lending gains cannot be determined,” but does not mention that the program’s indirect impact on lending can be, and is being, measured.

As structured by Congress, SBLF—similar to many other government programs—operates through an indirect mechanism to achieve policy outcomes. By definition, an institution's receipt of SBLF capital does not have a “direct impact” on small business lending. Rather, the program's impact on lending is indirect. The additional lending capacity provided by SBLF capital, coupled with the program's dividend rate incentives, encourages banks to increase lending. Treasury's reporting measures this indirect impact.

For programs that use indirect mechanisms to achieve policy outcomes, best practices for evaluation include a comparison of outcomes between program participants and a comparison group closely matched on key characteristics (see, for example, the Government Accountability Office's *Designing Evaluations: 2012 Revision, GAO-12-208G*). Consistent with these best practices, Treasury includes a detailed peer and comparison set analysis to measure the program's impact in its Use of Funds reports.

The analysis completed by GAO indicated that the small business lending “growth rates of SBLF participants remain noticeably higher than those of [their] peer group.”³ Treasury's analysis confirms this finding. In any program evaluation, there are likely to remain some factors for which a peer analysis or other assessment is unable to adjust. The potential effect of these

³ *Ibid*, page 28.

residual factors, however, does not mean that such assessments are invalid or that, as the Report asserts, there is no “accurate means of measuring the impact” of SBLF.

4. The Report states that OIG’s audits have “disclosed a significant number of errors” in participant reporting; however, the Report does not disclose that these errors total less than 0.1 percent of small business lending reported by all participants.

OIG reports that it has conducted three audits of SBLF participant lending results, identifying \$170 million in purported errors. This amount in fact represents less than 1 percent of small business lending reported by the audited institutions and less than 0.1 percent of small business lending reported by all participants. And, by OIG’s own accounting, these errors have collectively resulted in a slight under-statement—not an over-statement—of small business lending increases.⁴

In view of their small magnitude, the errors that OIG identified would have no material effect on overall program reporting. Thus, the Report’s statement that these errors mean that Treasury’s reporting does not “present an accurate picture of . . . small business lending activity” is simply not true.

5. OIG’s analysis of SBLF participants’ lending plans misconstrues their contents and its misguided critique of Treasury’s approach comes over two-and-a-half years after the fact.

The Report states that “over half of participants . . . are not on pace to meet projections” based on its analysis of small business lending plans submitted at the time of participants’ applications for funding in early 2011. This analysis misconstrues the information collected in the lending plans.

The projections in these plans were not required by law and were not intended to be used to measure individual participant performance. Congress did not link the dividend rate incentives to the lending plans. The dividend rate incentives are based on fixed percentage increases in small business lending – irrespective of what an institution projected in its lending plan.

The information in the lending plans was used by Treasury and the federal banking agencies to assess the safety and soundness of a bank’s small business lending ambitions and to optimize capital allocation at the time of application. The published instructions for the lending plans clearly described this delineation, stating:

“An institution’s performance will be measured through the dividend or interest rate it pays for funding from the Small Business Lending Fund. Dividend or interest rate adjustments will be determined by each bank’s percentage increase in qualified small business lending over its ‘baseline’ level rather than on information provided in the lending plan.”

Evaluating individual institutions based on their lending plan projections leads to the unfair result that institutions that put forward more challenging plans are identified as being “not on pace” to meet goals, even if their lending growth exceeds that of other institutions. Because each

⁴ Because some errors resulted in under-statements while others resulted in over-statements, the \$170 million in gross errors reported by OIG resulted in a \$51 million under-statement on a net basis. The banks examined in the three audits collectively have \$5.5 billion in outstanding small business lending, indicating an average error rate of less than 1 percent (\$51 million divided by \$5.5 billion).

SBLF bank receives the same incentives, Treasury strongly believes that evaluating institutions based on these incentives provides a more meaningful measure of program outcomes.

For these reasons, Treasury disagrees with OIG's use of lending plan projections as a measure of an individual institution's performance and with OIG's view that this was a "missed opportunity." However, Treasury would have been pleased to modify the language contained in the lending plan form to better facilitate OIG's analysis if OIG had requested that Treasury collect this information at the time of the form's publication in December 2010 or at any point since. Since the program's two-year incentive period concludes this quarter, it is no longer possible to make this modification.

* * *

Treasury will implement the Report's recommendations by supplementing its program reporting. Attached please find more specific responses to each of your recommendations.

Thank you once again for the opportunity to review and comment on the Report. We appreciate OIG's work over the course of this audit.

Sincerely,

A handwritten signature in black ink, appearing to read "Don Graves, Jr.", written in a cursive style.

Don Graves, Jr.
Deputy Assistant Secretary

Recommendations

- 1. Revise the title of the *Use of Funds Report* to more accurately reflect the report's contents.**

Management Response

Treasury accepts this recommendation. Treasury will revise the title of the Use of Funds Report to "Report on SBLF Participants' Small Business Lending Growth."

- 2. Report only those small business lending gains in the *Use of Funds Report* that were realized after SBLF funding.**

Management Response

Treasury will continue to report small business lending gains that were realized after SBLF funding in future reports and will continue to report small business lending gains as compared to the statutory baseline as well.

Treasury included a detailed data set reflecting small business lending gains since second quarter 2011 (the quarter immediately prior to the receipt of funding by most SBLF participants) in the *July 2013 Use of Funds Report*. Treasury included this information in addition to reporting on changes in lending since the baseline period established by Congress. Removing information about lending gains following the baseline period established by Congress—and reporting information "only" on lending following SBLF funding—would reduce transparency and create inconsistencies between the program's financial and policy reporting.

- 3. Disclose that reported small business lending gains cannot be directly linked to the use of SBLF funds.**

Management Response

Treasury accepts this recommendation. As structured by Congress, SBLF operates through an indirect rather than a direct mechanism to achieve policy outcomes. Treasury describes the program's structure in the "background" section of the Use of Funds Reports. In future reports, Treasury will include the specific statement that program performance can be measured only indirectly—and therefore lending gains cannot be directly linked to SBLF funds—because Congress structured the program using an indirect mechanism.

- 4. Disclose whether gains were concentrated among a few institutions or more widely distributed when reporting the aggregate dollar increase in lending of participating institutions.**

Management Response

Treasury accepts this recommendation. In future reports, Treasury will disclose the distribution of gains on a dollar basis. Treasury already includes an analysis that shows the distribution of gains on a percentage basis in its Use of Funds Reports.

-
- 5. Ensure that recommended changes made to the *Use of Funds Report* are reflected in the 2013 *Results of the First Annual SBLF Lending Survey* report.**

Management Response

Treasury accepts this recommendation. Treasury will update the 2013 *Results of the First Annual SBLF Lending Survey* report to include the statements described in Treasury's response to OIG's third recommendation. Treasury will include the analyses requested in the second recommendation in future publications of the annual lending survey results.

- 6. Amend the 2013 *Results of the First Annual SBLF Lending Survey* report to acknowledge that a comparison of projected and actual increases in small business lending may differ from that reported due to variances in projection periods used by participants; and either make the same disclosure in future survey reports or perform an individualized analysis to measure actual progress by participants.**

Management Response

Treasury accepts this recommendation. Treasury will update the 2013 *Results of the First Annual SBLF Lending Survey* report to reiterate this acknowledgement in the context of the lending plan projection periods. Treasury notes that the potential for variances is already acknowledged in the 2013 *Results of the First Annual SBLF Lending Survey*. For example, Treasury's description of the survey methodology states that "The practice of conducting any survey may introduce errors, such as difficulties interpreting a particular question, which can introduce idiosyncratic variability into the survey results."

Appendix 3: Major Contributors

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Appendix 4: Distribution List

Department of the Treasury

Deputy Secretary
Office of Strategic Planning and Performance Management
Risk and Control Group

Office of Management and Budget

OIG Budget Examiner

United States Senate

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Committee on Small Business and Entrepreneurship

Chairman and Ranking Member
Committee on Finance

Chairman and Ranking Member
Committee on Banking, Housing and Urban Affairs

Chairman and Ranking Member
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Appropriations Subcommittee on Financial Services and General
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United States House of Representatives

Chairman and Ranking Member
Committee on Small Business

Chairman and Ranking Member
Committee on Financial Services

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Deputy Director, Corporate Management Control