Office of the Special Inspector General for Pandemic Recovery
Office of Audits

Interim Report: Audit of the Effects the Main Street Lending Program's Loan Losses Have on Treasury's Investment in the Program

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March 31, 2023

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TO: Jacob D. Leibenluft
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SUBJECT: Interim Report: Audit of the Effects the Main Street Lending Program's Loan Losses have on Treasury's Investment in the Program A-23-002-2

The purpose of this interim report is to provide information about data we are collecting from banks on the performance of their Main Street Lending Program (MSLP) loans. We are collecting and reviewing this information as part of our *Audit of the Effects the Main Street Lending Program's Loan Losses Have on Treasury's Investment in the Program (A-23-002).*

The most recent update from the Board of Governors of the Federal Reserve System, dated March 10, 2023, reports that the MSLP has recognized approximately $115 million in actual loan losses as of February 28, 2023. An independent audit[1] of the Special Purpose Vehicle established by the Federal Reserve to run the MSLP shows an allowance for loan losses of $1.07 billion as of December 31, 2022.[2] This same audit reports $2 billion in loans in non-accrual status at the end of 2022.[3] SIGPR had been unable to obtain any of the detail behind this loan loss information. Therefore, SIGPR issued subpoenas to 47 MSLP participating banks. The subpoenas requested banks to provide records pertaining to all MSLP loans held by the bank that met one or more of the following criteria:

- are or were in default;
- are or were at least 90 days delinquent in interest payments;
- are at least 90 days delinquent in providing quarterly or annual financial reports required by loan covenants;

[1] https://www.federalreserve.gov/aboutthefed/files/msllcfinstmt2022.pdf
[2] The allowance for loan losses consists of loan participations collectively evaluated for impairment and reflects an estimate of probable loan losses inherent in the loan portfolio.
[3] A loan is placed in non-accrual status if it becomes due and unpaid for 90 days (late interest payments, in the case of the current MSLP loan portfolio), or if management determines the collection of the full amount due is not probable.

- are or were deemed “impaired” by the banks or by outside auditors or examiners; or
- were made to a borrower for whom the bank has determined that there is a reasonable basis to suspect that the borrower made a material misrepresentation at any time during the loan process.

This interim report provides a summary of the results of subpoena responses that the Office of Audits has received to date.

Background

On April 9, 2020, the Board of Governors of the Federal Reserve System and Secretary of the Treasury announced the establishment of the MSLP under the authority of Section 13(3) of the Federal Reserve Act, with approval of the Secretary. In total, 319 lender banks participated in the MSLP issuing 1,830 loans to small and medium sized businesses. The total value of the loans issued was approximately $17.5 billion. The Federal Reserve Bank of Boston, which manages the program, set up a Special Purpose Vehicle (SPV) to purchase 95 percent of participations in MSLP loans from lender banks. These purchases were backed by a $16.6 billion equity investment by the Department of Treasury (Treasury). The lender banks retain the remaining 5 percent of the risk associated with making a loan.

All MSLP borrowers are required to provide certain financial reporting to their lender either quarterly or annually, depending on the report. Required reporting includes data on borrower assets, liabilities, expenses, net income, and other financial data. Borrowers are also required to provide a list of certifications and covenants, which includes a provision that any material misrepresentation made by the borrower would result in its loan becoming promptly due and payable.

Payment terms for MSLP loans are for five years. No payments are due in the first year. After the first year of the loan, interest payments become due in accordance with the loan agreement. No principal is paid in the first or second year of the loan. The loans are amortized over the remaining term of the loan with 15 percent of principal due at the end of year three, 15 percent due at the end of year four, and a balloon payment of 70 percent at the end of year five.

All MSLP loans were issued between July 2020 and January 2021 and are currently in year three of the loan term. Therefore, interest payments are the only payments that have been due to date. Principal payments will be due starting in July 2023 through January 2024, depending on the loan origination date.

Because of Treasury’s investment in the MSLP, SIGPR has sought to obtain detail behind the nature of the program’s reported $115 million in actual loan losses. SIGPR asked banks to provide information on defaults, which can be either technical (i.e. a breach of the loan covenants), or monetary (failure to make timely payment). With interest payments now due, SIGPR requested data on interest payments that were over 90 days delinquent. SIGPR also requested information on impaired loans, which are loans where the bank or another entity deems it probable that not all the loan principal and interest will be collected. Finally, SIGPR asked banks about compliance with financial reporting requirements, and whether banks were aware of any borrower material misrepresentations during the loan process.

Summary of Information Received to Date

As of March 29, 2023, SIGPR issued subpoenas to 47 lender banks. SIGPR selected banks for subpoena based on the number of MSLP loans issued, the dollar value of loans, and risk factors developed internally by the SIGPR Office of Audits. The subpoenas were sent out in three different tranches, as follows:

Figure 1 – Summary of Subpoenas

Tranche	Subpoena Due Date	# of Banks Subpoenaed	# of Responses
1	03/01/2023[4]	11	10
2	04/03/2023	10	6
3	04/26/2023[5]	26	0
TOTAL		**47**	**16**

The 47 subpoenaed banks have issued a total of 1,095 of MSLP loans, representing 60 percent of all MSLP loans. The 1,095 loans had a total loan value of over $10.1 billion, representing 58 percent of the MSLP total loan value.

As of March 29, 2023, 16 banks responded to our subpoenas. Those 16 banks provided us with information on whether any of their MSLP borrowers were in default; had delinquent interest payments; had delinquent quarterly or annual financial reporting; had loans that were deemed impaired; or who made material misrepresentations during the loan process. We also obtained information on loans that were paid back in full.

The following tables represent the information we have collected as of March 29, 2023:

Figure 2 – Summary of Responses Received Compared to All MSLP Loans

		MSLP Universe	% of MSLP Universe
Number of Banks	16	319	5%
Number of Loans Issued	778	1,830	42.5%
Dollar Value of Loans Issued	$5,512,077,276	$17,459,024,461	31.6%

[4] Two banks in tranche 1 were given extensions to March 15, 2023.
[5] One bank in tranche 3 was given a unique due date of April 7, 2023.

Figure 3 - Summary of 16 Subpoena Responses

	Count	$ Loan Value
Defaults	18	$204.3 million
Delinquent Interest Payments	17	$57.1 million
Delinquent Financial Reporting	181	$868.8 million
Impaired Loans	26	$158.5 million
Material Misrepresentation	2	$7.4 million
Paid Off	166	$1.24 billion

Conclusion

As of March 29, 2023, 16 banks responded to our subpoenas for MSLP loan information. Those 16 banks issued 778 MSLP loans, at a value of over $5.5 billion. That represents approximately 43 percent of the total number of MSLP loans issued, and 32 percent of the total dollar value.

SIGPR finds the information banks reported in response to the subpoenas significant considering that principal payments have not yet come due on any MSLP loan to date. Bank responses to our subpoenas show that of the 778 loans issued by the 16 responding banks, $204.3 million in loans are or were in default; $57.1 million in loans have or had delinquent interest payments; 181 borrowers are at least 90 days delinquent in providing required quarterly or annual financial reports; $158.5 million in loans are or were deemed impaired by the bank or by outside auditors or examiners; and 2 loans had borrowers where the bank determined that the borrower made material misrepresentations during the loan process. However, bank responses did show that 166 of the 778 loans, with a value of $1.24 billion, have been paid in full by the borrower.

This interim report is informational in nature, and no response is required. We plan to issue interim reports as we get more information.

Compliance Statement

In accordance with generally accepted government auditing standards (GAGAS), during an audit, the auditors may provide interim reports to appropriate entity and oversight officials. This communication is informational in nature and requires no further action from management.

The related ongoing audit, when completed, will comply with GAGAS. The associated performance audit report that will be issued in the future will incorporate the information discussed in this report.

Audit Team

This audit is managed and conducted by the individuals listed below:

Kevin Gallagher	Audit Manager
Corina Niner	Auditor-In-Charge

Memorandum Distribution

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