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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September 14, 2023

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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-23-002-4

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).* This is an update of Interim Report Number A-23-002-3, issued on May 12, 2023.

On August 10, 2023, the Board of Governors of the Federal Reserve System (Federal Reserve Board) reported that the MSLP has recognized approximately $164 million in actual loan losses as of July 31, 2023.[1] SIGPR requested that Treasury obtain MSLP loan default information on its behalf from the Federal Reserve Board. However, Treasury indicated that they are unable to obtain this information. Therefore, in order to obtain this information, 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;
- 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.

[1] On September 11, 2023, the Federal Reserve Board provided an updated actual loan loss figure of $210 million as of August 31, 2023.

This interim report provides a summary of the results of subpoena responses the Office of Audits has received from the 47 banks.

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 the 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. Therefore, interest payments are the only payments that have been due through the end of June 2023. The initial 15 percent principal payments became due for the earliest MSLP loans in July 2023, and will become due for all loans by January 2024.

Because of Treasury's investment in the MSLP, SIGPR has sought to obtain detail behind the nature of the program's reported $164 million in actual loan losses as of July 31, 2023. 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

In total, 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 47 subpoenaed banks have issued a total of 1,094 MSLP loans, representing 60 percent of all MSLP loans. The 1,094 loans had a total loan value of over $10.2 billion, representing 59 percent of the MSLP total loan value.

At this point, all 47 banks have responded to our subpoenas. The 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 from the 47 MSLP lender banks:

Figure 1 – Summary of Responses Received Compared to All MSLP Loans

	Subpoena Responses	MSLP Universe	% of MSLP Universe
Number of Banks	47	319	15%
Number of Loans Issued	1,094	1,830	59.8%
Dollar Value of Loans Issued	$10,224,112,602	$17,459,024,461	58.6%

Figure 2 - Summary of 47 Subpoena Responses

	Count	$ Loan Value
Defaults	74	$878.5 million
Delinquent Interest Payments	25	$121.2 million
Delinquent Financial Reporting	215	$1.1 billion
Impaired Loans	34	$228.9 million
Material Misrepresentation	5	$66.9 million
Paid Off	283	$2.9 billion

SIGPR Access to Loan Loss Information

As mentioned earlier in the report, SIGPR requested details behind the Federal Reserve Board's reported $164 million in actual MSLP loan losses as of July 31, 2023. We consider this amount to be significant considering that prior to June 30, 2023, no principal payments were due. SIGPR also finds the differences between the information reported by the MSLP lender banks (including 34 impaired loans valued at $228.9 million) and the $164 million actual loan loss amount to be noteworthy. Again, to accurately access Treasury's financial exposure from the MSLP declared loan losses, the SIGPR Office of Audits discussed obtaining detailed loan loss information with the Federal Reserve Board and the Federal Reserve Bank of Boston. We were informed that the Federal Reserve Board and Federal Reserve Bank of Boston would be "inclined" to provide the records that the Office of Audits requested with the "understanding that any confidential information provided to SIGPR in connection with the audit will not be made public and will be maintained within SIGPR's audit function and not used for investigative purposes." SIGPR was not able to agree with the conditions of use set forth by the Federal Reserve Board. Any such agreement, which potentially restricts the Office of Audits from sharing certain information with investigators under all circumstances, would potentially violate long established auditing standards. Therefore, we were not able to agree to the requested restrictions on use. As a result, on September 5, 2023, the SIGPR Office of Audits issued an IG subpoena to the Federal Reserve Bank of Boston to obtain the documents that identify the Main Street Lending Program loans comprising the approximately $164 million in actual loan losses as of July 31, 2023.

Initial MSLP Principal Payments Coming Due

As mentioned in the Background section of this report, the only MSLP borrower payments due through June 2023 have been interest payments. Principal payments (15% of the loan balance) become due at the end of Year 3 of each loan. The MSLP program granted 1,830 loans, from July 1, 2020 through January 5, 2021. Accordingly, the first principal payments became due starting in July 2023. As of the end of August 2023, the first principal payment became due on 173 of the 1,830 MSLP loans. Total principal payments due by January 5, 2024 total approximately $1.6 billion.

Conclusion

As of August 4, 2023, all 47 banks responded to our subpoenas for MSLP loan information. Those 47 banks issued 1,094 MSLP loans, at a value of over $10.2 billion. That represents approximately 60 percent of the total number of MSLP loans issued, and 59 percent of the total dollar value.

SIGPR finds this loan loss information significant considering that principal payments are just now becoming due on the earliest MSLP loans. Bank responses to our subpoenas show that of the 1,094 loans issued by the 47 responding banks, $878.5 million in loans are or were in default; $121.2 million in loans have or had delinquent interest payments; 215 borrowers are at least 90 days delinquent in providing required quarterly or annual financial reports; $228.9 million in loans are or were deemed impaired by the bank or by outside auditors or examiners; and 5 loans had borrowers where the bank determined that the borrower made material misrepresentations during the loan process. However, bank responses did show that 283 of the 1,094 MSLP loans, with a value of $2.9 billion, have been paid in full by the borrower.

The Federal Reserve Board reported that as of July 31, 2023, the MSLP has experienced $164 million in actual loan losses. SIGPR finds this to be significant considering that prior to June 30, 2023, no principal payments were due. SIGPR also finds the differences between the information we received from the MSLP lender banks and the $164 million actual loan loss amount declared by Federal Reserve Board to be noteworthy. In order to get more insight into the $164 million MSLP loan loss figure, the SIGPR Office of Audits issued a subpoena to the Federal Reserve Bank of Boston to obtain the documents that identify the MSLP loans comprising those losses.

Because MSLP loan principal payments are just now becoming due, it can be expected that the level of defaults, delinquent payments, and impaired loans will increase. In fact, three days prior to the issuance of this report, the Federal Reserve Board updated their actual loan loss figure to $210 million as of August 31, 2023. Treasury should coordinate with the Federal Reserve to monitor this situation and take action to ensure its investment in the MSLP is protected to the extent possible.

This interim report is informational in nature, and no response is required. We plan to issue additional 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
Victor Martinez	Auditor-In-Charge

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