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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May 12, 2023

Office of the Special Inspector General for Pandemic Recovery

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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-23-002-3

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-23-002-2, issued on March 31, 2023.

The most recent update from the Board of Governors of the Federal Reserve System, dated April 10, 2023, reports that the MSLP has recognized approximately $136 million in actual loan losses as of March 31, 2023. An independent audit[1] of the Special Purpose Vehicle (SPV) 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] A comparison of this loan loss information to other lenders can be found in the *MSLP Loan Loss Comparison* section of this report.

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;

[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 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.

This interim report provides a summary of the results of subpoena responses that the Office of Audits has received to date, and an analysis of how MSLP loan loss information compares to loan loss data from similarly situated 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 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 $136 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 May 9, 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 47 subpoenaed banks have issued a total of 1,097 MSLP loans, representing 60 percent of all MSLP loans. The 1,097 loans had a total loan value of over $10.2 billion, representing 59 percent of the MSLP total loan value.

As of May 9, 2023, 39 banks responded to our subpoenas. Those 39 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 May 9, 2023:

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

	Subpoena Responses	MSLP Universe	% of MSLP Universe
Number of Banks	39	319	12%
Number of Loans Issued	1,008	1,830	55.1%
Dollar Value of Loans Issued	$8,509,622,697	$17,459,024,461	48.7%

Figure 2 - Summary of 39 Subpoena Responses

	Count	$ Loan Value
Defaults	48	$560.1 million
Delinquent Interest Payments	22	$98.2 million
Delinquent Financial Reporting	209	$1.1 billion
Impaired Loans	30	$192.3 million
Material Misrepresentation	3	$8.9 million
Paid Off	237	$2.1 billion

MSLP Loan Loss Comparison

In order to provide context to the loan loss data reported by the independent audit[4] of the SPV (MS Facilities, LLC) established by the Federal Reserve to run the MSLP, we reviewed loan loss data from banks with a similar dollar volume of loan participations to MS Facilities, LLC for the year ended December 31, 2022. MS Facilities, LLC had approximately $11.7 billion in outstanding loan participations at year end December 31, 2022. We reviewed the Federal Reserve's listing of large U.S. commercial banks as of December 31, 2022.[5] From this list, we reviewed individual banks' financial statements to find a group of banks with a similar dollar volume of loans held. We found 11 banks with outstanding loan participations ranging from $10.3 billion to $14.7 billion and compared their loan data in regard to allowance for loan losses, loans in non-accrual status, and net charge-offs.

The data shows that MS Facilities, LLC's loan loss figures greatly exceed those from banks with a similar amount of loan participations. Specifically, MS Facilities, LLC's allowance for loan losses, non-accrual loans, and net charge-offs were far greater than all 11 banks we found for comparison. See *Figure 3*:

Figure 3 – Comparison of MS Facilities, LLC to Banks with Comparable Loan Volume
(for the year ended December 31, 2022)

Bank	Loan Participations	Allowance for Loan Losses	Allowance as % of Net Loans	Non-Accrual Loans	Net Charge Offs
A	$10.3 billion	$133.0 million	1.29%	$28.6 million	$12.6 million
B	$10.7 billion	$117.8 million	1.10%	$38.2 million	$1.6 million
C	$10.8 billion	$110.8 million	1.03%	$6.3 million	$2.8 million
D	$11.2 billion	$157.6 million	1.40%	$21.0 million	$8.5 million
E	$11.6 billion	$192.1 million	1.66%	$56.5 million	$7.3 million
F	$11.6 billion	$158.4 million	1.36%	$13.4 million	($0.9 million)
MS Facilities, LLC	$11.7 billion	$1.1 billion	9.09%	$2.0 billion	$79.9 million
G	$12.0 billion	$223.3 million	1.86%	$42.3 million	$2.7 million
H	$12.2 billion	$120.2 million	0.99%	$66.0 million	$0.9 million
I	$13.6 billion	$142.2 million	1.05%	$38.6 million	$0.6 million
J	$14.4 billion	$110.8 million	0.77%	$27.0 million	$2.3 million
K	$14.7 billion	$195.7 million	1.33%	$30.9 million	$10.6 million

Banks' Average	$12.1 billion	$151.1 million	1.25%	$33.5 million	$4.4 million
MS Facilities, LLC	$11.7 billion	$1.1 billion	9.09%	$2.0 billion	$79.9 million

[4] https://www.federalreserve.gov/aboutthefed/files/msllcfinstmt2022.pdf

[5] FRB: Large Commercial Banks-- December 31, 2022 (federalreserve.gov)

Conclusion

As of May 9, 2023, 39 banks responded to our subpoenas for MSLP loan information. Those 39 banks issued 1,008 MSLP loans, at a value of over $8.5 billion. That represents approximately 55 percent of the total number of MSLP loans issued, and 49 percent of the total dollar value.

In addition, a comparison of loan loss information between MS Facilities, LLC, and banks with a similar dollar volume of loan participations shows that the allowance for loan losses, loans in non-accrual status, and charge-offs are far greater with the MSLP loan portfolio than they are with loans from comparable banks.

SIGPR finds this loan loss information 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 1,008 loans issued by the 39 responding banks, $560.1 million in loans are or were in default; $98.2 million in loans have or had delinquent interest payments; 209 borrowers are at least 90 days delinquent in providing required quarterly or annual financial reports; $192.3 million in loans are or were deemed impaired by the bank or by outside auditors or examiners; and 3 loans had borrowers where the bank determined that the borrower made material misrepresentations during the loan process. For the year ended December 31, 2022, the data on MSLP as a whole shows $2 billion in loans over 90 days delinquent and $79.9 million in charge-offs. This data on delinquencies and charge-offs indicates a far greater incidence of delinquent payments and loan losses than lenders with a similar volume of loan participations as the MSLP. However, bank responses did show that 237 of the 1,008 MSLP loans, with a value of $2.1 billion, have been paid in full by the borrower.

The MSLP was set up to help small and medium sized businesses that were in sound financial condition prior to the onset of the pandemic to maintain their operations and payroll until conditions normalized. MSLP lenders were required to assess each borrower's pre-pandemic financial condition and post-pandemic prospects to determine eligibility for a loan. The high level of MSLP loan charge-offs and loans in non-accrual status calls into question whether Treasury should have taken a more active role in oversight of the program to protect its investment and help ensure the program was administered as intended.

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
Corina Niner	Auditor-In-Charge

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