LUSE GORMAN September 29, 2010

LEGAL UPDATES AND NEWS

Small Business Lending Fund for Community Banks

On September 27, 2010, the Small Business Jobs Act of 2010 (H.R. 5297) (the "Act") was enacted into law. The Act creates a $30 billion Small Business Lending Fund ("SBLF") that will provide capital to community banks to support their small business lending. Interested banks should evaluate this program carefully before participating since there will be reporting obligations and additional paperwork, as well as conditions attached to any SBLF investment, including higher dividend rates payable to the U.S. Treasury if small business lending is not increased. We expect Treasury will issue term sheets for its investments in community banks in the near future.

Eligibility for SBLF Capital Investments

Under the SBLF, the U.S. Treasury will make capital investments in eligible institutions by purchasing preferred stock or other financial instruments (such as debt instruments for which the eligible institution is fully liable or equity equivalent capital). Eligibility is limited to insured depository institutions and their holding companies with less than $10 billion in total consolidated assets. Institutions with less than $1 billion in assets will be eligible for investments of up to 5% of risk-weighted assets. Institutions with between $1 billion and $10 billion in assets will be eligible for investments of up to 3% of risk-weighted assets. Prior to making an investment in an eligible institution, Treasury will consult with the institution's primary federal regulator and, if the institution is a state-chartered bank, it will consider any views received from the state regulator.

In addition to whatever application materials will be required by the Treasury, applicants for SBLF investments must submit to their primary federal (and, if applicable, state) regulator a small business lending plan "describing how the applicant's business strategy and operating goals will allow it to address the needs of small businesses in the areas it serves." The application must also include a plan to provide "linguistically and culturally appropriate" outreach, where applicable. The plan will be considered confidential supervisory information.

Institutions that are on the FDIC's "problem bank list" (i.e., with a CAMELS rating of 4 or 5), or that have been off of the problem bank list for less than 90 days, are not eligible to participate (and the Treasury is authorized to deny an application of an institution even if it is not on the problem bank list). In addition, if an institution's primary regulator would not otherwise recommend it for participation, Treasury may give special consideration to an institution that is able to raise matching private capital. Existing participants in the TARP Capital Purchase Program ("CPP") will be able to refinance their CPP capital for SBLF investments, provided they have not missed more than one dividend payment due under the CPP. Unlike the CPP, there will be no employee compensation restrictions associated with an SBLF investment.

Timing for SBLF Capital Investments

The Treasury is expected to issue term sheets for its SBLF investments during the next few weeks, and no investments will be made until then. In the meantime, we encourage interested community banks to contact their applicable federal or state regulator if they are interested in participating in the program.

Incentives for Small Business Lending

The SBLF program encourages small business lending by reducing the 5% base dividend rate on SBLF capital investments as a participating institution increases lending to small businesses. Specifically, for each participating institution, a baseline of its small business lending is established, using call report data from the four full quarters immediately preceding enactment of the Act.

During the first two years of the program, a participating institution may *decrease* the base dividend rate by 1% for each 2.5% *increase* in small business lending over the baseline, down to a minimum dividend rate of 1%. At the end of the two-year period, the dividend rate is locked in. However, if an institution's small business lending at the end of the two-year period has remained the same or decreased relative to its baseline, the dividend rate will be 7% until the end of the 4 ½-year period beginning on the date of the initial investment. In addition, to encourage repayment of the investment, the dividend rate for each participating institution will increase to 9% at the end of the 4 ½-year period, regardless of lending activity. The investment must be repaid in full after 10 years.

Participating institutions are required to conduct outreach to minorities, women, and veterans through targeted advertising describing the availability of, and application process for, receiving loans from the institution. In addition, the primary federal banking regulator for each participating institution is required to issue guidance on prudent underwriting standards that must be used for loans made by the institution using SBLF funds. The institution must also disclose to borrowers that the loan, if applicable, is made possible by the institution's participation in the program. It must also post on its website that the institution is seeking to make small business loans to qualified borrowers and may not discriminate on an unlawful basis.

* * *

Luse Gorman has advised numerous financial institutions in connection with capital-raising transactions, including through U.S. Treasury programs such as the TARP Capital Purchase Program. For further details regarding this newsletter, please contact any of the attorneys listed below.

Eric Luse ■ (202) 274-2002
John J. Gorman ■ (202) 274-2001
Alan Schick ■ (202) 274-2008
Richard S. Garabedian ■ (202) 274-2030
Lawrence M.F. Spaccasi ■ (202) 274-2037
Kip A. Weissman ■ (202) 274-2029
Michael Epshteyn ■ (202) 274-2025