**Board of Governors of the Federal Reserve System**
**Federal Deposit Insurance Corporation**
**Office of the Comptroller of the Currency**
**Office of Thrift Supervision**

# UNDERWRITING STANDARDS FOR SMALL BUSINESS LOANS ORIGINATED UNDER THE SMALL BUSINESS LENDING FUND PROGRAM

The federal banking agencies[1] are issuing this guidance on underwriting standards for lending conducted under the Small Business Lending Fund (SBLF) Program. The SBLF was created pursuant to the Small Business Jobs Act of 2010 ("the Act"), which directs the Secretary of the Treasury to make capital investments in eligible financial institutions to address the ongoing effects of the financial crisis on small businesses and increase their access to credit.[2] To carry out this goal, the Act authorizes the U.S. Department of the Treasury to purchase up to $30 billion in preferred stock and other financial instruments from financial institutions to increase the availability of credit for small businesses. Further, the Act requires the federal banking agencies to issue guidance regarding prudent underwriting standards for small business loans made with SBLF funds by participating institutions.

The federal banking agencies expect SBLF participants to extend credit in a safe and sound manner with prudent risk selection and credit risk management processes. Each participating institution's board of directors should ensure that its small business lending policy is consistent with safe and sound credit practices and supportive of the institution's participation in the SBLF Program. The small business lending policy should address prudent loan portfolio diversification by establishing growth rates and concentration standards as a percentage of capital for different loan types, industries, borrower groups, and collateral support. Participating institutions should ensure that their management, lending, and credit administration functions have sufficient experience and resources to successfully conduct small business lending. Institutions should continue to include small business loans within their credit risk review and grading process as appropriate, and account for these credits and associated allowances for loan and lease losses in accordance with generally accepted accounting principles. This guidance applies to small business loan originations and renewals, purchased loans, and loan participations made under the SBLF program.

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[1] The federal banking agencies consist of the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS).

[2] Title IV, Subtitle A, Section 4102 (18) of the Act defines small business lending as "lending, as defined by and reported in an eligible institution's [sic] quarterly Call Report, where each loan is one of the following types: (i) Commercial and industrial loans; (ii) Owner-occupied nonfarm, nonresidential real estate loans; (iii) Loans to finance agricultural production and other loans to farmers; and (iv) Loans secured by farmland." This definition excludes any loan with an original amount greater than $10 million or that goes to a business with more than $50 million in gross revenues.

## Underwriting Standards for SBLF Program

Participating institutions will have considerable latitude in formulating underwriting standards for this program. The following guidelines are broad in nature and allow participating institutions to tailor lending policies and products to the needs of small businesses in their communities. This guidance generally reflects the provisions of Section 39(a) of the Federal Deposit Insurance Act, which directs the agencies to establish minimum guidelines for credit underwriting and loan administration. The *Interagency Guidelines Establishing Standards for Safety and Soundness,*[3] which implement Section 39(a), establish standards for prudent credit underwriting practices. Under these standards, prudent underwriting practices: (1) are commensurate with the loan types and terms offered; (2) consider the nature of the markets where the loans are made; (3) consider the borrower's willingness and ability to repay; (4) establish a credit review process; (5) take adequate account of concentration risk; and (6) are appropriate for the institution's size, nature, and business activity.

The standards described below are consistent with the underwriting standards and loan administration principles established in the *Interagency Guidelines for Real Estate Lending Policies*[4] and the *Interagency Statement on Meeting the Needs of Creditworthy Small Business Borrowers.*[5] Further, if the loan involves a Small Business Administration ("SBA") guaranty or other support, the institution should adhere to the SBA's requirements as applicable.

Prudently underwritten small business loans should reflect all relevant credit factors, including:

- Capacity of the income from the business to adequately service the debt.
- Value and quality of the collateral.
- Overall creditworthiness of the borrower.
- Level of equity invested in the business.
- Any secondary sources of repayment.
- Any additional collateral or credit enhancements (such as guarantees or key-person insurance).

For most small business loans, the primary source of repayment is the cash flow of the business, either through the conversion of current assets or ongoing business operations. An institution's cash flow analysis of the business should cover current and expected cash flows, and reflect expectations for the borrower's performance over a reasonable range of future conditions, rather than overly optimistic or pessimistic cases. Many small business borrowers also rely on

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[3] See FRB: 12 CFR part 208, Appendix D-1; FDIC: 12 CFR part 364 Appendix A; OCC: 12 CFR part 30, Appendix A; and OTS: 12 CFR Part 570, Appendix A.

[4] See FRB: 12 CFR part 208 subpart E; FDIC: 12 CFR part 365; OCC: 12 CFR part 34, Subpart D, Appendix A; and OTS: 12 CFR part 560

[5] See "Interagency Statement on Meeting the Credit Needs of Creditworthy Small Business Borrowers," issued on February 12, 2010.

their personal wealth and resources to support loan requests.  A borrower's credit history and financial strength, including credit score and debt-to-income level, are components of assessing willingness and ability to repay, and should be considered in conjunction with other subjective factors, such as the strength of management.  The loan structure should be appropriate for meeting the funding needs of the borrower given the type of credit and expected timing of the business' cash flow.  Further, an institution should analyze the secondary sources of repayment, such as the strength of any guarantor or collateral support, and the ability of the borrower to provide additional capital.  Institutions should not place excessive reliance on cyclical factors, such as appreciating or depreciating collateral values.