United States Senate
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
WASHINGTON, DC 20510–6075

May 18, 2020

The Honorable Jerome H. Powell
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave NW
Washington, DC 20551

The Honorable Steven T. Mnuchin
Secretary
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Chairman Powell and Secretary Mnuchin:

I write regarding the $600 billion Main Street Lending Program (MSLP) and other facilities being developed by the Federal Reserve Board (Federal Reserve or Fed) and the Treasury Department under the Coronavirus Aid, Relief, and Economic Security Act (the CARES Act). Congress granted the Treasury Department and the Federal Reserve considerable discretion to create tools to support our economy as the nation copes with the COVID-19 pandemic. However, that power carries with it a duty to be deliberate and avoid unintended outcomes or structural biases.

As the Federal Reserve works to establish the Main Street lending facilities, the Fed's decisions on the features and requirements of the those facilities will influence which businesses receive loans and as a result have a better chance to remain viable, keep workers employed, and sustain their communities. The Federal Reserve's announcement last month to amend and expand the MSLP highlights how ostensibly technical changes can affect the scope and consequences of the program. My colleagues and I wrote to you separately about how the Fed's changes appeared to respond to the special interests of troubled oil and gas companies[1] and lacked adequate explanation. Given the significance of the Fed's decisions, it is crucial that the Federal Reserve and the Treasury explain the rationale for changes to any CARES Act lending program requirements and how the changes fulfill the goals of the CARES Act and accomplish an overall

[1] https://www.schatz.senate.gov/press-releases/schatz-whitehouse-senators-to-fed-loans-should-help-small-businesses-not-bail-out-oil-companies-that-risk-stability-of-financial-system.

strategy that helps workers and preserves jobs, and doesn't just pay a business's lenders and shareholders.

The Paycheck Protection Program (PPP), administered by the Treasury and the Small Business Administration (SBA) provides several lessons that can inform the creation of the Main Street Lending Programs. Like the PPP, the Main Street Lending Program uses banks to provide funding to businesses. Placing banks at the center of the program creates an overreliance on the ability and willingness of banks to help all businesses that need it by making the extra effort to go beyond the safest, easiest, and most lucrative customer relationships.[2] Banks' desire for the path of least resistance appeared as an early and recurrent flaw in the PPP—when some banks favored a subset of existing customers over others and over new customers.

This favoritism became clear in the first round of the PPP, the $349 billion allocated by Congress was exhausted in less than two weeks, with more than 25% of the funding going to less than 2% of the firms.[3] Moreover, banks earned $10.5 billion in processing fees in the first PPP round, even as thousands of small businesses were left waiting. Congress last month provided additional PPP funding, including allocations for smaller financial institutions. Despite this important step to broaden access to small business loans, in the second round of the PPP, through May 8, the top three banks processed 26% of the new loans.[4]

The SBA Inspector General observed deficiencies in the execution of the PPP in a flash report issued this month.[5] The IG identified several key suggestions for the SBA to align the PPP with the CARES Act, including for SBA to issue guidance to lenders requiring the lenders to prioritize borrowers in underserved markets and revise the PPP borrower application to include the collection of optional demographic information for principals for the remaining available lending authority and any future lending under the program.

Based on the problems observed with the PPP, you should incorporate the following operational and program features into the MSLP.

- *Prioritize access for small and medium sized businesses and lending to underserved areas*. To better serve small and medium sized businesses and underserved communities, including communities of color and rural communities, the MSLP should target small and mid-sized banks in underserved communities by purchasing loan participations for the MSLP facilities on a preferred basis from those institutions' smaller customers and minority and women owned businesses. In addition, the Fed should allocate a substantial portion of the MSLP funding to smaller banks, or for small and medium sized businesses, and permit them exclusive access to process loans with the MSLP for defined periods and

[2] https://www.nytimes.com/2020/04/22/business/sba-loans-ppp-coronavirus.html.
[3] https://www.sba.gov/sites/default/files/2020-05/PPP%20Deck%20copy.pdf.
[4] https://www.sba.gov/sites/default/files/2020-05/PPP_Report_200508.pdf.
[5] https://www.sba.gov/sites/default/files/2020-05/SBA_OIG_Report_20-14_508.pdf.

devote resources to assist with managing the documentation and operational processes. To further promote small and mid-sized bank lending, and avoid domination by large banks, the Fed should also consider establishing a cap on MSLP capacity for each bank.

- *Require banks to work with new customers to access the MSLP*. Under the MSLP facilities, lenders will retain either 5 or 15 percent of the loans provided to businesses, creating the need to carefully evaluate borrowers' ability to repay the loans. This underwriting analysis not only favors businesses that were "in sound financial condition before the onset of the COVID-19 pandemic," it pushes banks to work with existing customers and may result in many small and medium-sized businesses waiting longer to receive loans. Accordingly, the MSLP should be established with requirements that banks work with new customers.

- *Build the program with transparency in mind*. As the SBA IG noted, PPP documentation did not require the collection of optional demographic information, so it is "unlikely the SBA will be able to determine the loan volume to the intended prioritized markets."[6] Given this fundamental missing link, the MSLP documentation for applicants and the intermediary banks must collect data and other information that will permit thorough analysis of lending in underserved areas. Collecting comprehensive data will also allow your agencies to report more complete information and achieve greater transparency and accountability to Congress and the American people.

- *Provide standardized documentation for applicants*. In order to help smaller borrowers and lenders evaluate loan terms and avoid having to scrutinize varying documentation from different banks, the Federal Reserve should provide banks standard loan documentation for borrowers. To date, the Fed has announced that the MSLP will use uniform documentation only for each facility to purchase loan participations from lenders. Standard terms for borrowers would in turn assure the Fed of the consistency in the loans it acquires through the MSLP. The use of standard documents would also facilitate future supervisory reviews, providing bank examiners a way to assess how lenders served their customers.

- *Focus on small and medium-sized businesses that were doing well before the pandemic*. To ensure that dollars are targeted to achieve Congressional intent of helping businesses harmed by the pandemic, the Federal Reserve should refrain from using the MSLP as a means to help companies paper over existing problems arising from excessive leverage, international price competition, and concerns about long-term viability. To this end, the Federal Reserve must only lend to businesses that need loans due to the pandemic. Finally, some in Congress note that aid to state and local governments should not be used

[6] *Id*.

to repay for existing debt, similarly the MSLP should not be used to refinance any company’s outstanding debt.

Treasury and the Fed must address these considerations in establishing the CARES Act lending facilities. The decisions you make will define the effectiveness of not only the MSLP, but also other lending programs that you develop. Several programs are not yet operational, and you still have access to more than $250 billion dollars of the taxpayer funds Congress appropriated in the CARES Act that has not been committed to a lending facility. I urge you to consider fully how you can best serve small and medium sized businesses and their workers and states and municipalities.

Sincerely,

Sherrod Brown
Ranking Member