



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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November 7, 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-23-002-5

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-23-002-4, issued on September 14, 2023.

In our September 14, 2023 interim report, we detailed our attempts to get access to the details behind MSLP loan loss data reported by the Federal Reserve Board. In a report dated August 10, 2023, the Federal Reserve Board reported that the MSLP has experienced approximately \$164 million in actual loan losses as of July 31, 2023. On September 5, 2023, SIGPR issued a subpoena to the Federal Reserve Bank of Boston to obtain the documents that identify the MSLP loans comprising the \$164 million. The Federal Reserve responded to our subpoena on October 5, 2023. This interim report provides summary data on the information we obtained on MSLP loan losses.

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.



Office of the Special Inspector General for Pandemic Recovery

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 were the only payments 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.

Loan Loss Data and Correlation to Fraud

We received MSLP loan loss data from the Federal Reserve Board on October 5, 2023. The data showed a listing of MSLP loans that the Federal Reserve Bank of Boston's SPV recognized as losses as of July 31, 2023. According to the data, 43 MSLP loans have been declared losses by the SPV. These 43 loans amount to \$164 million in charge-offs. After reviewing this information, SIGPR issued three subpoenas to MSLP lenders to obtain the loan files for selected MSLP loans.

We noted that among the 43 MSLP loans that the SPV recognized as losses, several are under investigation for alleged fraud on the part of the borrower. The table below captures statistics on the number of charged-off loans under criminal investigation:

Figure 1 – Loans Declared Losses Under Investigation

	Number	Amount
Loans Charged-Off	43	\$164,115,308
Loans Charged-Off Under Investigation	21	\$72,843,636

As shown in *Figure 1*, 21 of the 43 MSLP loans that the SPV recognizes as losses are under investigation for alleged fraud. Therefore, approximately 49 percent of the loans, and 44 percent of the loan dollars declared a loss in the program so far have borrowers under investigation for alleged fraud.



Updates Show Increases in MSLP Loan Losses

The loan loss data covered in this report represents MSLP loans declared a loss by the SPV as of July 31, 2023. However, the Federal Reserve Board's latest update shows an increase in the loss amount. According to its latest Periodic Report issued on October 10, 2023, the MSLP actual loan loss figure is up to \$257 million as of September 30, 2023. This represents a \$93 million increase from the figure reported two months earlier.

As MSLP borrowers' initial 15 percent principal payments continue to become due over the next couple of months, it is reasonable to assume the losses will continue to increase significantly. For example, one MSLP borrower recently contacted SIGPR after reading our reporting on MSLP loan loss information to ask for guidance in working with their lender. The borrower indicated that it will be unable to make its initial principal payment. This borrower has an MSLP loan of over \$10 million.

As of September 30, 2023, only 312 of the 1,830 loans in the MSLP universe have reached the initial principal payment due date. Those 312 loans represent only approximately 17 percent of the number of loans, and 19 percent of the money lent. Between October 1, 2023 and January 5, 2024, the initial principal payments become due on the remainder of the MSLP loans.

Conclusion

As of July 31, 2023, the Federal Reserve Bank of Boston's SPV has recognized \$164 million in actual loan losses. Those losses cover 43 MSLP loans. SIGPR finds it noteworthy that of the 43 loans recognized by the SPV as losses, 21 loans are or were part of an investigation for alleged fraud.

Initial principal payments still have not become due on the vast majority of MSLP loans, and those initial principal payments will not have come due on all MSLP loans until January 2024. Because of this, it is reasonable to conclude that the SPV's amount of recognized loan losses are likely to increase significantly in the coming months. For example, the latest update from the Federal Reserve Board shows that recognized loan losses have increased by \$93 million in the two-month period between July 31, 2023 and September 30, 2023, during a time when initial principal payments started to become due.

On October 25, 2023, SIGPR issued a subpoena to the Federal Reserve Bank of Boston for the detail behind the additional \$93 million in loans that have been declared a loss since July 31, 2023. SIGPR will continue to monitor the MSLP loan portfolio and work with the Federal Reserve Board and Federal Reserve Bank of Boston to remain up to date on MSLP loan losses as they are recognized.

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
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Audit Manager
Auditor-In-Charge



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Federal Reserve Bank of Boston

Federal Reserve Board of Governors