Evaluation Report
2023-FMIC-B-011
July 17, 2023

Board of Governors of the Federal Reserve System

The Board and FRB Boston Generally Followed Their Process for Purchasing MSLP Loan Participations but Can Formally Document Some Key Processes

Office of Inspector General
Board of Governors of the Federal Reserve System
Consumer Financial Protection Bureau

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Executive Summary, 2023-FMIC-B-011, July 17, 2023

The Board and FRB Boston Generally Followed Their Process for Purchasing MSLP Loan Participations but Can Formally Document Some Key Processes

Findings

All 35 of the loans in our sample had complete and properly executed lender-submitted loan documents, as required by the Main Street Lending Program (MSLP), and the special purpose vehicle (SPV) team performed its required reviews for 33 of the 35 loans. However, the credit administrator did not conduct the required prepurchase reviews for 2 loans to confirm that accounting data matched loan documentation because the SPV did not define its documentation expectations. Rather, the credit administrator reviewed some accounting data during the postpurchase review of loan documents for these two loans. Obtaining and reviewing loan documentation ensures that the loan participations conform to program expectations.

In addition, the Board of Governors of the Federal Reserve System's Legal Division and the Federal Reserve Bank of Boston's (FRB Boston) Legal Department have not documented the general process for addressing potentially ineligible loans in a manner consistent with internal control standards. According to a Board official, the process is not formally documented because the current process is well established. Documenting a framework for reviewing potentially ineligible loans can preserve institutional knowledge and help ensure consistency.

Finally, we identified a matter for management consideration. Specifically, the SPV has not formally documented its processes to review loan participation purchases. The program's $1.0 billion loan loss allowance, coupled with actual loan losses of $136 million as of April 30, 2023, could result in public scrutiny of loan participation purchases. Documenting the loan purchasing process, including the successes and challenges associated with each process, can help the SPV retain institutional knowledge in MSLP loan participation purchases, thereby reducing its reputational risk.

Recommendation

Our report contains a recommendation designed to help the Board and FRB Boston ensure consistency in their process for determining whether loans were purchased based on inaccurate borrower certifications. In response to our draft report, the Board and FRB Boston concur with our recommendation and outline actions to address the recommendation. We will follow up to ensure that the recommendation is fully addressed.

Purpose

The objective of our evaluation was to assess the design and operating effectiveness of the Board and FRB Boston's process for purchasing MSLP loan participations. The scope of our evaluation focused on MSLP loan participations purchased from December 1, 2020, to January 8, 2021, because 64 percent of all MSLP loan participations were purchased during this period. We focused on the three for-profit MSLP lending facilities: the Main Street Expanded Loan Facility, the Main Street New Loan Facility, and the Main Street Priority Loan Facility. We excluded the two nonprofit MSLP lending facilities because one of these facilities did not extend any loans and the other extended loans that accounted for less than 1 percent of the total number of loans made.

Background

The COVID-19 pandemic disrupted economic activity in the United States. To support lending to businesses and nonprofits, the Board authorized the MSLP using section 13(3) of the Federal Reserve Act, with prior approval of the U.S. Department of the Treasury's secretary. The MSLP is administered by FRB Boston, which established an SPV to purchase loan participations from eligible lenders.

Office of Inspector General
Board of Governors of the Federal Reserve System
Consumer Financial Protection Bureau

Recommendations, 2023-FMIC-B-011, July 17, 2023

The Board and FRB Boston Generally Followed Their Process for Purchasing MSLP Loan Participations but Can Formally Document Some Key Processes

Finding 1: The SPV Has Complete Loan Documentation and Generally Followed Its Review Processes

Number	Recommendation	Responsible office
	No recommendations.	

Finding 2: The Board and FRB Boston Established but Have Not Documented Their Process for Addressing Potentially Ineligible MSLP Loans

Number	Recommendation	Responsible office
1	Document a framework outlining the general process for identifying, determining, and pursuing action on ineligible loans as well as the key roles and responsibilities for addressing potentially ineligible MSLP loans.	The Board's Legal Division and FRB Boston's Legal Department

Office of Inspector General
Board of Governors of the Federal Reserve System
Consumer Financial Protection Bureau

MEMORANDUM

DATE: July 17, 2023

TO: Distribution List

FROM: Cynthia Gray
Deputy Associate Inspector General for Audits and Evaluations

SUBJECT: OIG Report 2023-FMIC-B-011: *The Board and FRB Boston Generally Followed Their Process for Purchasing MSLP Loan Participations but Can Formally Document Some Key Processes*

We have completed our report on the subject evaluation. We conducted this evaluation to assess the design and operating effectiveness of the Board of Governors of the Federal Reserve System and the Federal Reserve Bank of Boston's (FRB Boston) process for purchasing Main Street Lending Program loan participations.

We provided you with a draft of our report for review and comment. In your response, you concur with our recommendation and outline actions to address our recommendation. We have included your response as appendix B to our report.

We appreciate the cooperation that we received from the Board and FRB Boston during our evaluation. Please contact me if you would like to discuss this report or any related issues.

cc: Kenneth Montgomery
Matthew J. Eichner
Andreas Lehnert
Jason Gonzalez
Bernard Kim
Melissa Ku
Jeff Walker
Casey Clark
Jason Hinkle
Steffanie Brady
Erin Boland
Rut Parrish
Jon Colvin
Alicia Grasfeder

Ricardo A. Aguilera
Cheryl Patterson

Distribution:
Mark E. Van Der Weide, General Counsel, Board
Steven Wright, Senior Vice President and General Counsel, FRB Boston
Joe Lynch, Vice President and Main Street Operations Director, FRB Boston

Contents

Introduction

Objective

The COVID-19 pandemic disrupted economic activity in the United States, which heightened the need for businesses to obtain credit to manage cash flows and sustain operations until economic conditions normalized. To support lending to businesses and nonprofits, under section 13(3) of the Federal Reserve Act and with prior approval by the U.S. Department of the Treasury's secretary, the Board of Governors of the Federal Reserve System authorized the Main Street Lending Program (MSLP). The Coronavirus Aid, Relief, and Economic Security (CARES) Act also authorized the treasury secretary to make loans, loan guarantees to, and other investments in the MSLP and other emergency lending facilities authorized by the Board.[1] The MSLP enabled lenders to issue MSLP loans to eligible borrowers. The MSLP purchased a 95 percent participation in eligible MSLP loans, and the lender retained the remaining 5 percent of the loan's value, allowing the risk of the loan to be shared.

The objective of this evaluation was to assess the design and operating effectiveness of the Board and the Federal Reserve Bank of Boston's (FRB Boston) process for purchasing MSLP loan participations.[2] The scope of our evaluation focused on loan participations purchased through the three for-profit MSLP lending facilities from December 1, 2020, to January 8, 2021.[3] To assess the design of the Board and FRB Boston's process for purchasing MSLP loan participations, we reviewed Board and FRB Boston documents and conducted interviews with relevant officials. To assess the operating effectiveness of the loan participation purchasing process, we judgmentally selected 35 loan participations and assessed their compliance with the loan participation purchasing process. Details on our scope and methodology are in appendix A.

Background

MSLP Overview

Section 13(3) of the Federal Reserve Act permits the Board of Governors, in "unusual and exigent circumstances," to authorize the Federal Reserve Banks to extend credit to participants in any program or facility with broad-based eligibility, with the prior approval of the U.S. Department of the Treasury's secretary. In addition, the CARES Act authorized, among other things, the Board's ability to extend

[1] The Consolidated Appropriations Act, 2021 (Pub. L. No. 116–260) prohibited the Board and the Federal Reserve Banks from reestablishing any emergency lending programs that received CARES Act funding.

[2] *Loan participation* means that some or all of the interest in a loan is shared or sold to other lenders. Loan participations allow banks to enhance their liquidity, diversify their loan portfolio, and serve the credit needs of borrowers.

[3] We did not include the two nonprofit MSLP lending facilities in the scope of our evaluation because one did not extend any loans and the other accounted for less than 1 percent of the total number of loans made and dollars loaned by the MSLP. Further, we focused on loan participations purchased between December 1, 2020, and January 8, 2021, because of the surge in loan submissions during this time frame that accounted for 64 percent of all MSLP loan participations purchased.

liquidity to support lending to businesses, as well as Treasury's investment in certain emergency lending facilities established by the Board.

The MSLP was designed to help credit flow to small and medium-sized for-profit businesses and nonprofit organizations that were in sound financial condition before the onset of the COVID-19 pandemic but needed loans to help maintain their operations until they recovered from, or adapted to, the effects of the pandemic. The MSLP comprises the following five emergency lending facilities: the Main Street Expanded Loan Facility, the Main Street New Loan Facility, the Main Street Priority Loan Facility, the Nonprofit Organization Expanded Loan Facility, and the Nonprofit Organization New Loan Facility.

The Board authorized FRB Boston to administer the MSLP. FRB Boston created a special purpose vehicle (SPV)—a separate legal entity—to purchase loan participations from eligible lenders across the United States.[4] The program offered 5-year loans with deferred principal payments for 2 years and deferred interest payments for 1 year to assist those experiencing temporary cash flow interruptions. Lenders were allowed to rely on borrower certifications that they were eligible for the loan, such as having a significant amount of their operations based in the United States. However, lenders were required to verify certain items during their underwriting practices. Specifically, lenders were required to

- conduct due inquiry with respect to borrower certifications to determine that the borrower is a business and was established before March 13, 2020, as well as to review the borrower's lien certifications and covenants[5]
- use customary underwriting practices, such as reviewing borrower financial records, to assess credit worthiness
- certify that the loan was subject to certain terms and conditions (for example, that the loan has not been allowed to be subordinated to other debt)

Once an eligible lender issued an MSLP loan to an eligible borrower, the lender submitted loan participation information to the SPV for purchase, including the following six completed documents:[6]

- **Participation agreement:** The agreement under which the SPV purchases a 95 percent participation in an eligible loan.
- **Borrower certifications and covenants:** The borrower certifications stating eligibility to obtain the loan participation and agreeing to covenants related to section 13(3) of the Federal Reserve Act, the CARES Act, the Board's Regulation A, and other MSLP term sheets.

[4] An *SPV* is formed by an organization as a separate company with its own legal identity, assets, and liabilities. Typically, SPVs are used to isolate financial risks from the parent organization.

[5] *Due inquiry* sets out the duty of care between contracting parties by requiring that lenders conduct reasonable diligence efforts.

[6] An *eligible lender* is a U.S. federally insured depository institution, a U.S. branch or agency of a foreign bank, a U.S. bank holding company, a U.S. savings and loan holding company, a U.S. intermediate holding company of a foreign banking organization, or a U.S. subsidiary of any of the foregoing. An *eligible borrower* is a business that (1) was established before March 13, 2020; (2) is not an ineligible business; (3) has either 15,000 employees or fewer, or had 2019 annual revenues of $5 billion or less; (4) was created or organized in the United States or under the laws of the United States with significant operations in and a majority of its employees based in the United States; (5) does not participate in the Primary Market Corporate Credit Facility or have existing loans in another MSLP facility; and (6) has not received specific support pursuant to subtitle A of title IV of the CARES Act.

- **Lender transaction–specific certifications and covenants:** The eligible lender certifications in which the borrower confirms that eligibility requirements have been met and agrees to covenants based on the relevant MSLP term sheets.
- **Assignment executed in blank:** Advance consent by the eligible lender and the eligible borrower that allows the SPV to assign the loan or transfer loan rights. This assignment is intended for the SPV to elevate its participation to be in privity with the borrower in limited circumstances, such as when a borrower has become the subject of bankruptcy
- **Co-lender agreement:** Advance agreement that takes effect when the SPV, in limited circumstances, elevates its participation in the loan to be on par with the initial lender or sells its interest to another lender, to allow for direct enforcement of the terms of the loan.
- **Servicing agreement:** The agreement establishing that the SPV will pay the eligible lender an annual servicing fee for reporting on the borrower's financial information, assets, and liabilities.

Once the loan was purchased by the MSLP, the SPV and the lender shared a mutual interest in its repayment. Specifically, the SPV purchased a 95 percent participation in MSLP loans, and the lender retained the remaining 5 percent participation.

MSLP Key Stakeholders

The SPV leveraged FRB Boston staff and vendors to administer the MSLP. Key stakeholders in the loan participation purchase process included the following:

- **The credit administrator:** The SPV contracted with an external vendor to assist with asset purchase intake services for the MSLP. The credit administrator's asset purchase intake responsibilities included (1) registering lenders, (2) reviewing and confirming that all MSLP-required documents had been obtained from lenders and were appropriately completed, and (3) validating the accuracy of accounting data.

- **Legal stakeholders:** The SPV used a combination of internal legal resources from FRB Boston, the Federal Reserve Bank of New York, and the Board, as well as external legal vendors, to support the purchase of loan participations. The legal stakeholders ensured that the legal documentation of each loan participation was complete and met MSLP requirements. Further, the Board's Legal Division assisted FRB Boston's Legal Department to determine whether MSLP loans met certain requirements at the time of purchase.

- **The MSLP Executive Oversight Committee (EOC):** FRB Boston established the EOC to oversee MSLP strategic policy and operational matters and to make key decisions to support the MSLP's implementation and ongoing operations. The EOC comprises 13 voting members who are leaders from a variety of FRB Boston divisions and offices, such as the Office of the President; the Legal Department; Corporate Strategy and Risk; and Supervision, Regulation, and Credit. The EOC also includes nonvoting members, such as representatives from FRB Boston's General Auditor and the Board's Division of Reserve Bank Operations and Payment Systems.

MSLP Loan Participation Purchasing Process

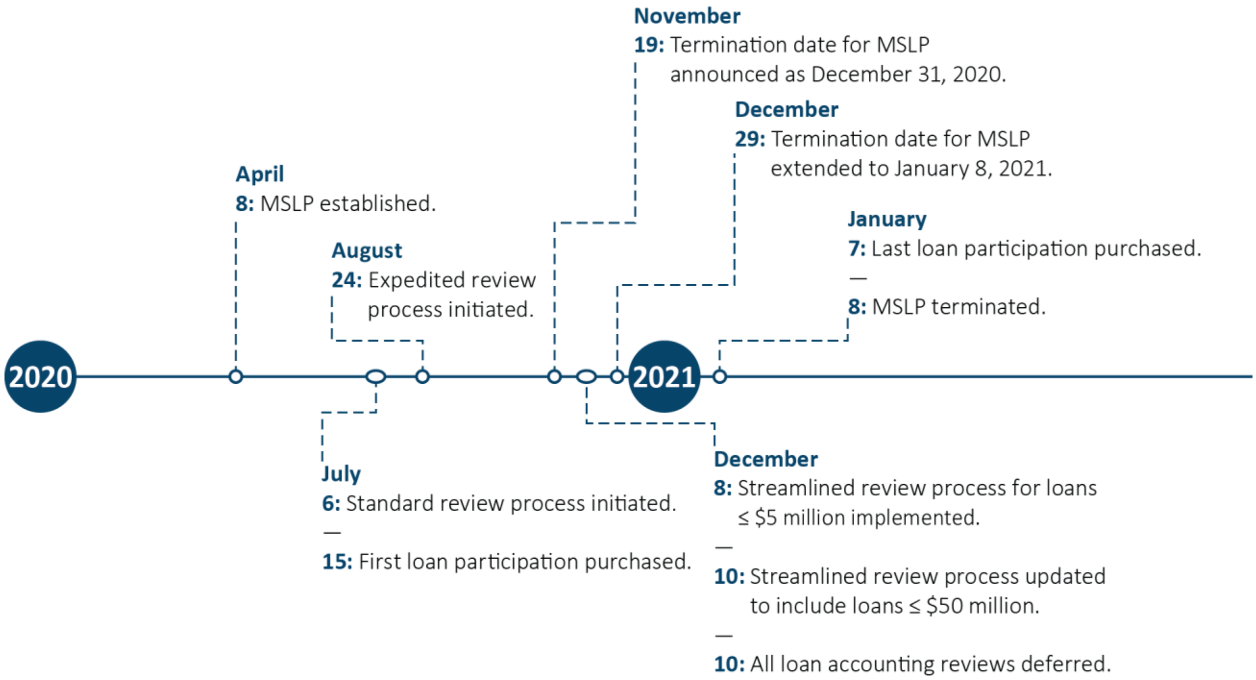
From July 6, 2020, through December 14, 2020, the SPV accepted new loan participation funding requests. The SPV initiated the MSLP with one standard loan participation purchase review process for all loans, but by December 2020 it had created two additional processes to help it manage the high volume of loan applications. To review the loan participation requests, the SPV team used the following separate review processes:

- Standard review process: The SPV established this process at the outset of the program for loan participation requests received from July 2020 through mid-December 2020. The standard review process required that the credit administrator, the SPV team, and legal stakeholders review the loan file in its entirety before the SPV purchased the loan participation.
- Expedited review process: In August 2020, the SPV implemented the expedited review process to allow the SPV to focus on (1) first-time submissions, (2) lenders that required multiple resubmissions on prior loan participation purchases, and (3) more-complex transactions. Lenders that had requested less than $5 million and successfully passed the required legal documentation review a minimum of three times without document resubmission requests qualified for the expedited review process. Only two lenders qualified for the expedited review process. The expedited process deferred all legal reviews of the loan documentation until postpurchase.
- Streamlined review process: In December 2020, the SPV implemented the streamlined review process to meet the increased demand for MSLP loans associated with the November 2020 Treasury announcement that the program would terminate at the end of the year. The SPV team determined eligibility for the streamlined review process based on the dollar amount requested and the backlog of applications for loan participation purchases. The streamlined review process was initially available only for loans participation requests under $5 million but was expanded to loan participation requests of up to $50 million. The streamlined review process deferred some legal reviews of the required loan documentation and the accounting review until postpurchase.

MSLP Timeline

The Board and FRB Boston established the MSLP, developed terms of the program, and established operating procedures in a short time. Specifically, the Board established the MSLP in April 2020. By July 2020, the MSLP began purchasing loan participations. By the time the MSLP closed in January 2021, three different purchase processes had been established and approximately $17.5 billion in loans had been issued (see figure).

Figure. MSLP Timeline



Source: OIG analysis of MSLP documents and interviews with Board, FRB Boston, and SPV officials.

Finding 1: The SPV Has Complete Loan Documentation and Generally Followed Its Review Processes

All 35 of the loans we reviewed had complete and properly executed loan documentation. Further, the SPV team performed its required reviews for the 33 standard and streamlined loans in our sample. However, for the 2 expedited loans in our sample, the SPV team did not perform its prepurchase review to confirm that accounting data entries matched loan documentation. Rather, the credit administrator reviewed some accounting data during the postpurchase review of loan documents for these 2 loans. The SPV did not define its expectations for how the credit administrator should document its prepurchase review of accounting data. Reviewing loan participation requests—including the accounting data—and obtaining complete and properly executed loan documents ensures that the loan participation purchases conform to program expectations.

The SPV Team Generally Conducted the Required Reviews

All 35 loans we reviewed had the six required lender-submitted MSLP documents and the critical fields, such as borrower and lender signatures, completed on each form. Further, the SPV team performed the required prepurchase and postpurchase reviews for the 33 loans in our sample purchased through the standard and streamlined review processes. The SPV team, the credit administrator, and legal stakeholders also documented these reviews in standardized checklists. However, for the 2 expedited loans in our sample, the credit administrator documented the postpurchase review in a spreadsheet but did not conduct a prepurchase review of accounting data. The loan participation intake system to purchase MSLP loan participations included validation flags that confirm that accounting data match loan documentation. For these 2 loans, the system validation flags show that the accounting data matched loan documentation. Further, as part of its postpurchase review of loan documents for the 2 expedited loans in our sample, the credit administrator reviewed some accounting data; for example, the credit administrator verified the accuracy of the credit agreement date.

Eligible lenders were required to complete and submit the six required documents to the SPV. The SPV implemented document review processes to ensure that (1) each loan participation met MSLP requirements, (2) the required legal documents had been properly executed, (3) certain accounting details were accurate, and (4) exceptions identified during the review had been sufficiently addressed. The table provides an overview of the program’s requirements for each of the different review processes we tested and our results.

Table. Overview of Completion of Review Processes for Loans in Our Sample

Type of review	Review components	Completed
Standard loan participation purchase review process		
Prepurchase review	The credit administrator and the SPV team review accounting data, and legal stakeholders review legal documents.	✓
Prepurchase closure of exceptions	The credit administrator and the SPV team resolve exceptions identified in reviews.	✓
Expedited loan participation purchase review process		
Prepurchase review	The credit administrator confirms that accounting data match loan documentation.	✕[a]
Postpurchase review	The credit administrator reviews loan documents and resolves exceptions.	✓
Streamlined loan participation purchase review process		
Prepurchase review	The credit administrator and legal stakeholders conduct an abbreviated review of loan documents.	✓
Postpurchase review	The credit administrator, legal stakeholders, and the SPV team review the deferred loan documents and accounting data.	✓
Postpurchase closure of exceptions	The credit administrator and the SPV team resolve material exceptions identified in reviews.	✓

Source: OIG analysis of MSLP loan participation purchasing requirements and MSLP documents.

[a] The credit administrator reviewed some accounting data as part of its postpurchase review of the co-lender agreement.

The credit administrator's prepurchase reviews of expedited loans were not completed because the SPV did not define its expectations or develop review documents (such as checklists like those used for the standard and streamlined review processes) for the credit administrator to document their prepurchase reviews.

Reviewing loan participation requests—including the accounting data—and obtaining complete and properly executed loan documents ensure that the loan participation purchases conform to program expectations and help reduce reputational risk to the Board and FRB Boston.

Conclusion

We do not have a recommendation for this finding because the loan participation purchasing process has ended. Therefore, an ongoing need to address this issue does not exist. However, we included a matter for management consideration in this report that addresses the need for the SPV to clearly document its loan participation purchasing processes, including those for expedited loans.

Management Response

In their response to our draft report, the Board's General Counsel and FRB Boston's General Counsel concur with the conclusions in our report.

Finding 2: The Board and FRB Boston Established but Have Not Documented Their Process for Addressing Potentially Ineligible MSLP Loans

FRB Boston's Legal Department and the Board's Legal Division have established a general process for addressing potentially ineligible loans but have not documented that process. Internal control standards state that documentation provides the means to retain organizational knowledge and mitigates the risk of concentrating that knowledge with a few employees. According to a Board official, the Board and FRB Boston had not formally documented the process for determining whether loans purchased were ineligible because the process was well established. Formal documentation of the roles and responsibilities of key positions and the general process for reviewing loans that potentially had been ineligible when purchased can help the Board and FRB Boston preserve institutional knowledge and ensure consistency in a key process.

The Board and FRB Boston Have Established a General Process for Addressing Potentially Ineligible MSLP Loans

As noted in finding 1, the 35 loans in our sample—3 of which are potentially ineligible loans—had complete and properly executed loan documents, and the SPV team generally reviewed and approved the loan participation requests, as required.[7] Given the reliance on borrower certifications to confirm eligibility for purchase, FRB Boston's Legal Department and the Board's Legal Division have established a general but undocumented process to address potentially ineligible loans.[8] According to an FRB Boston employee, the stakeholders track potentially ineligible loans and follow this general process, as described by Board and FRB Boston stakeholders:

1. FRB Boston's Legal Department receives a referral of a potentially ineligible loan from sources such as the SPV, lenders, the media, or oversight bodies.

[7] Stakeholders in the Board and FRB Boston's process to determine potentially ineligible loans—including the Board, FRB Boston, and the Office of Inspector General—are aware of the three potentially ineligible loans in our sample. We did not confirm the outcome of these instances because they could be the subject of an ongoing legal proceeding or investigation.

[8] A loan purchased by the SPV is determined to be ineligible if at the time of purchase it does not meet CARES Act or other program eligibility requirements.

2. FRB Boston's Legal Department researches the facts related to the referral.
3. Following the research, FRB Boston's Legal Department refers potentially ineligible loans to the Board's Legal Division. The referral occurs through a written memorandum that includes information on the borrower's potential violation of program requirements or the CARES Act.
4. FRB Boston's Legal Department, in conjunction with the Board's Legal Division, determines whether additional information from the lender(s) and borrower(s) is necessary; analyzes the circumstances of the case; identifies potential remedies, such as making the loan promptly due for repayment or taking legal action; and resolves the issue. In certain instances, including those of suspected fraud, FRB Boston and the Board will refer the case to the Office of Inspector General or other appropriate authorities.

SPV REVIEW OF BORROWER ELIGIBILITY

In April 2022, the SPV team completed a one-time review of borrower eligibility at the time of the loan purchase. To conduct the review, the team evaluated 531 loan participations for borrower compliance with selected CARES Act requirements, such as whether at the time of the loan purchase (1) a majority of the borrower's employees and operations were located in the United States; (2) the borrower was not a covered entity in which covered individuals, such as certain elected or appointed officials, held a controlling interest in the equity of the borrower; and (3) the borrower was incorporated or organized under the laws of the United States. To conduct the review, the SPV team relied primarily on borrower-retained documents but also leveraged some public data. The SPV team did not identify any potentially ineligible borrowers during this review.

Internal control standards note that documentation provides the means to retain organizational knowledge and mitigate the risk of having that knowledge limited to a few personnel. Effective documentation helps capture the design of internal controls and communicate the who, what, when, where, and why of internal control execution. Documentation also provides a means to communicate that knowledge to external parties, such as external auditors, as needed.

According to a Board official, the agency had not formally documented the ineligible loan purchase determination process because the current process had been well established and the process for individual cases differed based on the specifics of each individual case.

Documenting a framework on the general process and the roles and responsibilities of key positions for reviewing potentially ineligible loans can preserve institutional knowledge by reducing reliance on key personnel and thereby reducing risks associated with turnover in key personnel. Further, documentation can ensure consistency in a key process. In the case of potentially ineligible MSLP loans, consistency in the process for addressing these loans is especially important considering that stakeholders are located across the Board and FRB Boston.

Recommendation

We recommend that the Board's Legal Division and FRB Boston's Legal Department

1. Document a framework outlining the general process for identifying, determining, and pursuing action on ineligible loans as well as the key roles and responsibilities for addressing potentially ineligible MSLP loans.

Management Response

In their response to our draft report, the Board's general counsel and FRB Boston's general counsel concur with our recommendation. The Board's Legal Division, in coordination with the Reserve Bank, has begun documenting the process for addressing potentially ineligible loans and the key roles and responsibilities. The Board and FRB Boston anticipate that they will document the process by the end of 2023.

OIG Comment

The actions described by the Board and FRB Boston appear to be responsive to our recommendation. We will follow up to ensure that the recommendation is fully addressed.

Matter for Management Consideration: The SPV Can Document Certain Elements of the Loan Purchasing Process to Help Retain Institutional Knowledge and Protect Against Reputational Risks

At initiation, the SPV began with one standard loan participation purchase review process for all loans. During 2020, the SPV created two deviations from its standard loan review process—expedited reviews and streamlined reviews—to help manage loan applications. FRB Boston implemented the expedited review process in August 2020 for lenders with a history of loan submissions that passed legal review of documentation without the need for document resubmissions. The SPV also implemented a streamlined review process in December 2020, which changed three times that month, to implement efficiencies and help the SPV address an increasing backlog of loan participation purchase requests.

Given the rapidly evolving circumstances, the SPV team did not clearly document the SPV's various loan participation purchasing processes. Specifically, the SPV team summarized the different review processes in various documents; however, elements of these processes were not fully documented.

- Standard review process: A user guide documents the credit administrator role as well as the SPV review and approval processes. The prepurchase legal review of loan documents is documented in a checklist template used during review of the loan documents; however, the roles and responsibilities of the different legal stakeholders in the legal review process is not documented.

- Expedited review process: The SPV has two documents that describe the expedited review process, a presentation and a procedural document, as well as a checklist template that is used to complete the postpurchase review of expedited loans. However, the prepurchase review of accounting data was not completed as part of the expedited review process presented to the EOC and is not documented in the procedural document. The SPV team did not define how the credit administrator should document the prepurchase review for the expedited loans.

- Streamlined review process: The SPV documented the streamlined review process primarily in risk acceptance memorandums and emails. In addition, according to a Board employee, the SPV team communicated changes to the streamlined review process in daily meetings. The Board employee further stated that written guidance on the changes discussed in daily meetings would have been helpful to reference when conducting their review of checklists completed by external legal stakeholders.

Further, the SPV team did not clearly document some of its key decisions in establishing the purchasing process, such as the SPV's decision to work with lenders to update incomplete applications rather than rejecting the loan package or the SPV's decision to give the credit administrator the authority to approve expedited loan participation purchases.

In addition, although the SPV team made changes as the program evolved, the team has not assessed program successes and challenges from the loan participation purchasing process. Documenting these successes and challenges can help retain organizational knowledge, as this knowledge is currently limited to the employees who actively participated in the purchase of the loan participations.

According to an SPV official, the SPV team has not performed a comparative analysis between the three processes because each process was created and used to help maximize the number of loans that the SPV team could review and accept into the program at that point in time. Finally, according to a Board employee, documenting successes and challenges may not be necessary, as the Board can only establish and operate the MSLP with congressional approval.

The Consolidated Appropriations Act, 2021, ended Treasury's ability to provide funds to reestablish emergency lending programs that received CARES Act funding, such as the MSLP.[9] Given that the loan purchase participation process is complete and the Board cannot reauthorize the MSLP without additional congressional approvals, we are not formally recommending that the SPV retroactively document its loan participation purchasing process or identify program successes and challenges. However, the SPV should consider doing so. As of April 30, 2023, FRB Boston has approximately $10.3 billion in outstanding loans to the SPV and actual loan losses totaling $136 million. In addition to actual losses, in April 2023 the SPV's estimated loan loss allowance was $1.0 billion.[10] Although the current actual and anticipated loan losses would be covered by Treasury's equity investment in the MSLP and the Board does not expect losses to the Federal Reserve System, there is the potential for public scrutiny in loan participation purchases as paydown continues on the lending portfolio. In addition, the MSLP has lost key personnel since its establishment, reducing institutional knowledge necessary to recreate the loan purchasing process. Documenting the loan purchasing process as well as related key takeaways can help the SPV reduce reputational risks related to the purchase of MSLP loan participations and help retain institutional knowledge of the program.

[9] Pub. L. No. 116–260, § 1005, 134 Stat. 2146, 2147.

[10] Loan loss allowances are used to estimate credit losses within a loan portfolio and are representative of the current amount of loans that are likely to not be collected based on current information about the loan portfolio.

Appendix A: Scope and Methodology

Our objective was to assess the design and operating effectiveness of the Board and FRB Boston's process for purchasing MSLP loan participations. The scope of our evaluation included loan participations purchased through the three MSLP for-profit facilities from December 1, 2020, to January 8, 2021.[11] Approximately 1,172 loans totaling $11.1 billion and accounting for 64 percent of the total MSLP loan purchases were issued from December 1, 2020, through January 8, 2021.

To assess the design of the Board and FRB Boston's process for purchasing MSLP loan participations, we reviewed relevant applicable laws, FRB Boston's internal documentation, and publicly available information, such as the MSLP's frequently asked questions and term sheets. We also conducted interviews with relevant officials from the Board's Legal Division, the Division of Reserve Bank Operations and Payment Systems, the SPV team, and FRB Boston's Legal Department.

To assess the operating effectiveness of the loan participation purchase process, we judgmentally selected a sample of 35 loan participations purchased by the SPV. Our sample includes loans that ranged in value from under $5 million to over $140 million, as well as loans purchased through each of the three loan participation purchase review processes. Three of the loans selected were identified as potentially ineligible. We also used data analytics to identify additional loans based on eligibility factors. We tested these loans for compliance with the SPV's loan participation purchase process by reviewing the completeness of the six required MSLP loan documents as well as evidence of SPV team, credit administrator, and legal stakeholder prepurchase and postpurchase reviews, as applicable. Because this is a nonstatistical sample, we are unable to project the results to the population of MSLP loan participation purchases.

We assessed the SPV's loan participation purchasing process administered by FRB Boston because the Board authorized the lending facilities and reports to Congress and the public in accordance with sections 11(s) and 13(3) of the Federal Reserve Act as well as the CARES Act. Moreover, the Board authorized FRB Boston to establish and operate the MSLP, and as such, the lending facilities, including the MSLP, are subject to the limitations, restrictions, and regulations of the Board.

We conducted our work from November 2021 to April 2023. At the end of our scoping phase, in July 2022, we split the original evaluation into two phases. Phase I focuses on the loan participation purchase process and is the subject of this report. Phase II focuses on the credit monitoring process for the loan portfolio and will be reported on separately. This evaluation was conducted in accordance with the Council of the Inspectors General on Integrity and Efficiency's *Quality Standards for Inspection and Evaluation*.

[11] We did not include the two nonprofit MSLP lending facilities in the scope of our evaluation because one did not produce any loans and the other produced loans that accounted for $42 million, or less than 1 percent of the total number of loans made and dollars loaned.

Appendix B: Management Response

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551

July 6, 2023

Cynthia Gray
Deputy Associate Inspector General
for Audits and Evaluations
Board of Governors
of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551

Dear Ms. Gray:

Thank you for the opportunity to comment on your report, *The Board and FRB Boston Generally Followed Their Process for Purchasing MSLP Loan Participations but Can Formally Document Some Key Processes.* We appreciate the effort that the Office of Inspector General (OIG) has put into this report and the recommendation it has provided to ensure consistency in the evaluation process for potentially ineligible Main Street Lending Program (MSLP) loans. The report found that the MSLP SPV had complete and properly executed loan documentation and generally followed loan review processes. The evaluation also noted that the Board and the Federal Reserve Bank of Boston (Reserve Bank) have an established process for addressing potentially ineligible MSLP loans and recommended formal documentation of that process.

The Board's Legal Division and the Reserve Bank agree with the conclusions in the report and have already begun action to document the framework used to address potentially ineligible loans.

In the report, the OIG makes the following recommendation:

1. *Document a framework outlining the general process for identifying, determining, and pursuing action on ineligible loans as well as the key roles and responsibilities for addressing potentially ineligible MSLP loans.*

   Management Response 1: We concur with this recommendation. The Legal Division, in coordination with the Reserve Bank, intends to document the process for addressing potentially ineligible loans and the key roles and responsibilities in that process by the end of 2023.

Regards,

Mark Van Der Weide
General Counsel
Legal Division

Steven Wright
Senior Vice President and General Counsel
Federal Reserve Bank of Boston

Abbreviations

CARES Act	Coronavirus Aid, Relief, and Economic Security Act
EOC	Executive Oversight Committee
FRB Boston	Federal Reserve Bank of Boston
MSLP	Main Street Lending Program
SPV	special purpose vehicle

Report Contributors

John Galvin, Senior Auditor
Michael Rivera, Senior Auditor
Alain Habimana, Auditor
Jennifer Venzor, Auditor
Darren Rector, Auditor
Olaiya Adeyemi, Auditor
Megan Taylor, OIG Manager, Financial Management and Internal Controls
Jackie Ogle, Senior OIG Manager for Financial Management and Internal Controls
Cynthia Gray, Deputy Associate Inspector General for Audits and Evaluations
Michael VanHuysen, Associate Inspector General for Audits and Evaluations

Contact Information

General

Office of Inspector General
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Mail Center I-2322
Washington, DC 20551

Phone: 202-973-5000
Fax: 202-973-5044

Media and Congressional

OIG.Media@frb.gov

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Board of Governors of the Federal Reserve System
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Mail Center I-2322
Washington, DC 20551

Phone: 800-827-3340
Fax: 202-973-5044