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Treasury and SBA Launch New Small Business Lending Program Amidst Confusion and Last Minute Changes – An Analysis of the New Program

COVID-19 Coronavirus Resources

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On March 27, 2020, Congress passed a historic $2 trillion package to address the economic fallout from the coronavirus pandemic (the CARES Act or the Act).[1] One of the law's key programs is the Paycheck Protection Program (PPP), which extends $349 billion in fully forgivable loans to small businesses, generally those with 500 or fewer employees, through the US Small Business Administration (SBA). In the past week, the SBA and the US Department of Treasury have issued initial guidance for the new program, which they then expanded and revised just hours before the program was officially launched earlier today, Friday, April 3, 2020. The preexisting lineup of 1,800 authorized SBA lenders can now distribute the loans, and lenders have reportedly processed over $2 billion in program funds as of 2:34 pm EST.[2]

But the PPP's $349 billion is nearly 12 times the amount of SBA loans for all of 2019, so challenges meeting demand are inevitable. Indeed, with late-issued guidance and a huge volume of applications expected, some lenders have expressed concern about their ability to meet expectations. JPMorgan Chase, for instance, emailed customers late Thursday stating that it would be unable to accept applications on April 3, 2020,[3] but did open the application process midday today for borrowers with an existing Chase Business checking account since February 15, 2020.[4] With the issuance yesterday of the interim final rule implementing the program (the Interim Final Rule) and the addition of terms that make the program more attractive to prospective lenders, the PPP is now underway.[5]

To meet demand, the CARES Act contemplates expansion of the network of lenders. The Act allows all sorts of financial institutions to provide lending through the program, including all federally insured depository institutions, federally insured credit unions, and Farm Credit System institutions, as well as additional nondepository lenders, such as fintechs. For its part, the SBA moved last night to address lender jitters by doubling the previously published interest rates anticipated for lenders and promising to advance payment to the lenders for anticipated amounts of loan forgiveness under the program. These incentives are in addition to those already provided in the CARES Act, including the 100% guaranty by the SBA, increased processing fees, waiver of all lender fees, and reduced underwriting requirements.

As relevant to borrowers, Treasury is already signaling that robust demand will quickly outpace the existing funding cap, given the attractive terms of the programs, and has mandated that more of the funds (75%) be used exclusively for payroll than previously indicated. Although the Treasury Secretary has said that he would return to Congress to seek additional funding in such circumstance,[6] borrowers who are interested in participating in the program should get their applications in as soon as possible.

This client alert summarizes the PPP program, including the newest developments for both prospective lenders and borrowers.

I. Key Issues For Lenders

The $349 billion appropriated for the PPP by the CARES Act will massively expand the lending mandate of the SBA's prior programs. According to government data, the SBA approved just $24 billion in 2019 in its flagship 7(a) program, and $30 billion for all SBA programs.[7] The PPP will therefore usher in a 12-fold increase over SBA's 2019 programs in a package intended for immediate, emergency relief. With existing lenders expressing doubts about the program, as noted above, additional lender capacity is obviously needed to carry out the program.

Additional Lenders

The CARES Act contemplates adding additional lenders to meet demand, and the SBA administrator and Treasury secretary have made clear they expect to rely on that added capacity. Under the Act, these "additional lenders" will be determined by the administrator of the SBA and the Secretary of the Treasury, based on an assessment of whether they have "the necessary qualifications to process, close, disburse and service loans made with the guarantee of the Administration."[8] In the Interim Final Rule, the SBA elaborated on the requirements to become a PPP lender: all federally insured depository institutions, federally insured credit unions, and Farm Credit System institutions that are not designated as in Troubled Condition or otherwise subject to an enforcement action regarding unsafe or unsound lending by their regulators are automatically qualified to issue loans upon submitting CARES Act Section 1102 Lender Agreement (SBA Form 3506). The Interim Final Rule does not, however, detail the process that the SBA will use to evaluate prospective lenders who are not automatically qualified to make PPP loans.

In addition, Treasury's guidance makes any depository or non-depository financing service eligible to make PPP loans so long as it:

- Originates, maintains, and services business loans or other commercial financial receivables and participation interests;
- Has a formalized compliance program and applies the anti-money laundering and other requirements of the Bank Secrecy Act (BSA);
- Has been operating since at least February 15, 2020; and
- Has either originated, maintained, and serviced more than $50 million in business loans or other commercial financial receivables during a consecutive 12-month period in the past 36 months *or* is a service provider to an insured depository institution with a contract to support that institution's lending activities and is in good standing with the appropriate federal banking agency.

Although the requirements are less stringent than those previously required under the SBA's 7(a) program, there are certain baseline anti-money laundering requirements. Specifically, any applicants that are not already required to apply the BSA standards must establish a compliance program equivalent to that of a comparable federally regulated institution. Those entities currently subject to the BSA should continue to follow their protocols for new customers, and PPP loans to existing customers will not require reverification under applicable BSA requirements.

Economics for Lenders

Becoming a lender will have its financial benefits, which were sweetened on the eve of the program's launch. Based on information in the CARES Act and the new SBA guidance:

- The SBA will compensate lenders with processing fees at a rate based on the balance of financing outstanding at the time of the final disbursement: 5% on loans of $350,000 or under; 3% for loans between $350,000 and $2 million; and 1% for loans greater than $2 million.
- The loans will also have a fixed interest rate—while in its initial guidance Treasury stated that the rate would be 0.5%, after pushback from the banks, the Interim Final Rule raised that interest rate to 1%, which it notes will provide a significantly higher yield than other comparable government guaranteed debt.[9]

- The SBA will guarantee 100% of the outstanding balance of the loan and will waive all guarantee fees, including upfront and annual servicing fees.
- The loans can be sold in the secondary market at a premium, and the SBA will not collect a fee for any guarantee sold into the secondary market. The SBA will issue guidance on advance purchases for PPP loans sold in the secondary market.
- Lenders can seek reimbursement of the expected forgiveness amount even before the borrower requests it. The Interim Rule allows the lender to request that the SBA purchase the expected forgiveness amount of a PPP loan at the end of week seven of the eight-week covered period, subject to the lender providing certain evidence supporting its request. Such expected forgiveness is the amount of loan principal the lender reasonably expects the borrower to expend on forgivable costs (expanded on below). The lender will receive these funds within fifteen days of the date on which the Administrator receives the lender's request and supporting evidence.[10]

Underwriting

As discussed below, the underwriting standards for approving a loan have been extraordinarily streamlined. In addition to fulfilling its anti-money laundering obligations discussed above, the lender must collect verifications from the borrower (all contained within the application itself) that it was in operation on February 15, 2020; that the borrower had employees for whom the borrower paid salaries and payroll taxes; the dollar amount of average monthly payroll costs; and confirm receipt of borrower certifications in the PPP Application form. These requirements are expanded on below.

In addition to the two-page application, the borrower is required only to submit for lender review documentation of its payroll, such as payroll processor records, payroll tax filings, or, if the borrower does not have that documentation, other documents such as bank records.

The lender must also submit a PPP Lender's Application for 7(a) Loan Guaranty (SBA Form 2484) electronically to the SBA. This form consists of information on the loan structure and amount, confirmation that the applicant has certified to the lender that they meet the requirements of the PPP (elaborated on below), and certification that the lender has followed the underwriting standards described above.

With respect to the eventual application for forgiveness of the loan, also described in more detail below, so long as a lender receives the required application and documentation attesting that the borrower accurately verified its payments for covered expenses, lenders can provide forgiveness without conducting any further verification and cannot be subject to enforcement actions or penalties if the borrower is in fact not in compliance.

According to SBA guidance on April 3, 2020, in order to apply to become a PPP lender, federally insured depository institutions, federally insured credit unions, and Farm Credit System institutions must fill out SBA Form 3506 and email it to DelegatedAuthority@aba.gov. It is not yet clear whether entities other than these will simply complete SBA Form 3506 to apply to become a PPP lender, or if any other documentation will be required.[11] Prospective lenders should stay alert for additional information.

II. Application Process for Prospective Borrowers

The PPP application process opened today, April 3, 2020. Lenders can now process applications for the PPP program for small businesses and sole proprietorships.[12] Although businesses have until June 30, 2020, to apply and submit the required documentation, businesses should apply as early as possible. As indicated above, the PPP has a funding cap, is expected to attract a huge volume of applications, and its loans are made on a first-come, first-serve basis.

A business may apply at any lender approved and enrolled in the program, and can use the SBA's online Find a Lender tool to see eligible PPP lenders.[13]

Eligibility

Eligible borrowers for PPP loans include:

- Any business concern, 501(c)(3) nonprofit, 501(c)(19) veterans' organization, or tribal business concern described in Section 31(b)(2)(C) of the Small Business Act with no more than: (1) 500 employees, or (2) such higher number established by the SBA on an industry-by-industry basis.[14]
- Sole proprietors, independent contractors, and other self-employed individuals.
- Businesses assigned a North American Industry Classification System (NAICS) code beginning with 72 (comprising establishments that provide customers with lodging and/or prepare meals, snacks, and beverages for immediate consumption) with 500 or fewer employees per physical location. Importantly, the Act waives the SBA affiliation rules (which specify that the number of employees is determined in the aggregate with a company's affiliates) for these businesses as well as certain other categories. Discussions are underway about waiving the affiliation rules for businesses beyond those specified in the Act,[15] and the SBA intends to issue additional guidance on affiliation rules for PPP loans.

Even if a prospective borrower falls in an eligible category above, the borrower may still be ineligible for a loan. Prospective borrowers are *ineligible* where:

- The applicant is a household employer (i.e., individuals who employ household employees such as nannies or housekeepers).
- The applicant is engaged in illegal activity under federal, state, or local law.
- The applicant or any owner of the applicant is suspended, debarred, proposed for debarment, declared ineligible, voluntarily excluded from participation in this transaction by any federal department or agency, or presently involved in any bankruptcy.
- The applicant, any of its owners, or any business owned or controlled by any of them obtained a direct or guaranteed loan from SBA or any other federal agency that is currently delinquent or has defaulted in the last seven years and caused a loss to the government.
- The applicant (if an individual) or any individual owning 20% or more of the equity of an applicant is presently subject to an indictment, criminal information, arraignment, or other means by which formal criminal charges are brought in any jurisdiction, or presently incarcerated, on probation or parole.
- For any felony within the last five years, the applicant (if an individual) or any owner of the applicant: (1) was convicted; (2) pleaded guilty; (3) pleaded nolo contendere; (4) was placed on pretrial diversion; or (5) was placed on any form of parole or probation (including probation before judgment).

Loan Terms

An eligible business can receive one PPP loan of up to the lesser of (a) $10 million or (b) 2.5 months of the applicant's average monthly payroll costs from the prior year[16] (subject to a prorated cap of $100,000 per employee). These loans are made on more favorable terms than usual SBA 7(a) loans:

- PPP loans are fully forgivable provided , for the eight weeks after the loan is made, the recipient: (1) uses the funds to pay for qualifying expenses, which include payroll costs (capped at 100,000 per employee, prorated), and payments for interest on mortgage debt incurred before February 15, 2020, rent on any lease in effect prior to February 15, 2020, and utility services that began before February 15, 2020; and (2) maintains full-time staff and at least 75% salary levels (for employees paid at $100,000 per year or less in 2019), compared to the prior year or first two months of 2020. The amount of forgiveness will scale down proportionally to any reduction in staff or reductions in salary in excess of 25%, as described above. However, any such reductions made between February 15, 2020, and April 26, 2020, will not reduce loan forgiveness so long as staff and salary levels are restored by June 30, 2020.

Notably, **no more than 25% of the loan proceeds may be used for non-payroll costs**. Any PPP funds used for unauthorized purposes will not be forgiven, borrowers could be subject to additional liability, such as charges for fraud, if they "knowingly use the funds for unauthorized purposes." In such circumstances, the SBA may have recourse against a borrower's shareholders, members, or partners.[17]

- PPP loans uniformly have a 1% interest rate,[18] a six-month payment deferral period (interest continues to accrue), and a two-year maturity. The loans also have no collateral or personal guarantee requirements—a significant departure from other SBA loans.
- The Act waives certain fees and prepayment penalties, as well as the usual requirement that a prospective borrower first try to obtain some or all of the loan funds elsewhere.

<u>Application Process</u>

The application process is significantly streamlined for PPP loans as compared to typical SBA loans. Prospective borrowers must complete a required application, which the SBA estimates will only take eight minutes. In completing the application, the applicant must certify, among other things, that:

- The applicant is eligible to receive a loan under the SBA rules in effect at the time the application is submitted.
- The applicant fits within an eligibility category as described above (including that it is not ineligible due to debarment, indictment, previous default, or criminal investigation).
- All SBA loan proceeds will be used for only business related purposes as specified in the loan application and consistent with the PPP.
- To the extent feasible, the applicant will purchase only American-made equipment and products.
- The applicant is in compliance with applicable Occupational Safety and Health Act requirements and will remain in compliance during the life of the loan.
- Current economic uncertainty makes the loan necessary to support the applicant's ongoing operations.
- The funds will be used to retain workers and maintain payroll or to make mortgage, lease, and utility payments, and the applicant understands if the funds are used for unauthorized purposes, the federal government may hold the applicant legally liable, including possible charges for fraud.
- The applicant understands that not more than 25% of the forgiven amount may be for non-payroll costs.
- During the period beginning on February 15, 2020, and ending on December 31, 2020, the applicant has not and will not receive another loan under the PPP.
- The lender will calculate the eligible loan amount using submitted tax documents (to verify payroll), and the applicant agrees the lender can share the submitted tax information with the SBA's authorized representatives, including the SBA Inspector General, for compliance with SBA loan requirements and SBA reviews.[19]

Individuals applying (i.e., sole proprietors, independent contractors, and certain self-employed individuals) must authorize the SBA to "request criminal record information about [the borrower] from criminal justice agencies for the purpose of determining [the borrower's] eligibility for programs authorized by the Small Business Act, as amended."[20]

As noted above, lenders will review the application subject to the limited underwriting standards described above. Although the Treasury Secretary and others have indicated that the program could result in same day approval with next-day funding, there are strong indications that the program will not have a smooth start, due to high demand from borrowers, lender limitations, and little or late guidance.[21]

EIDL Refinancing

Businesses who received COVID-19-related loans under the Economic Injury Disaster Loan program after January 31, 2020, but before the date that PPP loans are made available, can refinance those loans as part of a PPP loan. For the interplay between the EIDL and PPP programs, see our prior alert.

Forgiveness Request

Loan forgiveness requests should be submitted to the lender servicing the loan after the initial eight-week period has passed. The lender must make a decision within 60 days of receiving the application, which must include:

- Documentation verifying the number of full-time employees and pay rates during the applicable periods. This includes payroll tax filings submitted to the IRS and state income, payroll, and unemployment insurance filings.
- Documentation verifying payments made on qualifying expenses. This includes cancelled checks, payment receipts, transcripts of accounts, or other documents.
- A certification that the documentation is true and correct and that the forgiveness amount requested was used to retain employees or pay qualifying expenses.
- Other documentation the SBA Administrator determines necessary. The SBA has not yet identified any additional documents.[22]

Interested parties can find available resources at:

- Treasury PPP Resource Page
- PPP Interim Final Rule
- Find an Eligible Lender
- Borrower Application Form (SBA Form 2483)
- PPP Lender's Application for 7(a) Loan Guaranty (SBA Form 2484)
- CARES Act Section 1102 Lender Agreement (SBA Form 3506)

Jenner & Block will continue to monitor the program as new information becomes available, including more information regarding lenders. Please reach out to CARESAct@jenner.com or your primary Jenner & Block contact with any questions.

Jenner & Block offers a wide array of resources and lawyers with the types of experiences necessary to help our clients navigate the implications of these important new programs, led by our newly established COVID-19 Response Team. This team includes lawyers who played key leading roles in the country's response to the last economic crisis, including government veterans whose senior positions meant that they were intimately involved in the design of many of the government's most recent bailout programs, oversaw the loan application and distribution processes that were a key part of them, and ran and responded to the investigations that followed. For additional information and materials, please visit our COVID-19 / Coronavirus Resource Center or contact your Jenner & Block partner.

Click here to visit our COVID-19 / Coronavirus Resource Center

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[1] For a detailed overview of the CARES Act, see Jenner & Block's prior alert.

[2] Jovita Carranza (@SBAJovita), Twitter (Apr. 3, 2020, 2:34 pm), https://twitter.com/SBAJovita/status/1246143933731741697.

[3] Hugh Son, *White House Says Small Business Lending Program Will Be Running Friday, even as JPMorgan Says It's Not Ready* (Apr. 2, 2020), https://www.cnbc.com/2020/04/02/jpmorgan-says-its-not-ready-for-small-business-loan-applications-as-banks-await-treasury-guidance.html. In addition, Bank of America stated that as of April 3, 2020, it will only accept applications from small businesses who had a business lending *and* a business deposit relationship with the bank as of February 15, 2020. *Small Business Resources*, Bank Amer., https://about.bankofamerica.com/promo/assistance/latest-updates-from-bank-of-america-coronavirus/small-business-assistance? (last visited Apr. 3, 2020); Phill Hill (@philhill), Twitter (Apr. 3, 2020, 9:41 AM), https://twitter.com/philhill/status/1246070315421220864 (showing a screenshot of Bank of America declining a loan for lack of a prior relationship).

[4] *Small Business Administration (SBA) Paycheck Protection Program*, Chase for Bus., https://recovery.chase.com/cares1 (last visited Apr. 3, 2020).

[5] US Small Bus. Admin., Interim Final Rule: Business Loan Program Temporary Changes; Paycheck Protection Program (Apr. 2, 2020), https://home.treasury.gov/system/files/136/PPP--IFRN FINAL.pdf.

[6] *Id.*

[7] *See Table 2 – Gross Approval Amount by Program*, US Small Bus. Admin. (Dec. 31, 2019), available at https://www.sba.gov/document/report--small-business-administration-loan-program-performance.

[8] H.R. 748 § 1102(a)(2)(F)(iii) (2020).

[9] Interim Final Rule, *supra* n.5, at 11-12.

[10] A complete report includes: the PPP Application (SBA Form 2483) and any supporting documentation submitted with the application; the PPP Lender's Application for 7(a) Loan Guaranty (SBA Form 2484); any supporting documentation, and a "detailed narrative" explaining the assumptions used for determining that amount, the basis for those assumptions, why alternative assumptions were not used; any information obtained from the borrower since the loan was disbursed that the lender used to calculate the expected forgiveness amount, including the documentation required to apply for loan forgiveness; and any additional information the Administrator may require.

[11] US Small Bus. Admin, Lender Designation as Paycheck Protection Program (PPP) Lender (Apr. 3, 2020), https://content.govdelivery.com/accounts/USSBA/bulletins/284c0f0.

[12] Independent contractors and self-employed individuals may apply beginning April 10, 2020.

[13] To streamline the process, Treasury recommends a business contact its local lender to determine whether it is participating in the program.

[14] For example, preexisting SBA guidance states that "tobacco manufacturers" are considered "small" as long as they have fewer than 1,500 employees total.

[15] Treasury guidance is unclear on whether venture capital-backed borrowers with under 500 employees will be eligible borrowers. *See* Letter from Bobby Franklin, President & CEO, NVCA, to Steven Mnuchin, Sec'y, US Dep't of Treasury & Jovita Carranza, Admin'r., U.S. Small Bus. Admin. (Apr. 1, 2020) (available at https://nvca.org/wp-content/uploads/2020/04/NVCA-letter-re-PPP-application-and-affilition-guidance.pdf). Recent statements from House Rep. Kevin McCarthy state that venture-capital backed borrowers will be covered under forthcoming guidance from Treasury. Dan Primack, *Kevin McCarthy: Startups Will Be Eligible for Coronavirus Stimulus Loans*, Axios (Apr. 2, 2020), https://www.axios.com/coronavirus-vc-startups-small-business-loans-6ae9e125-fbbb-4349-

9d67-ce68d4a5ac57.html.

[16] Because independent contractors can apply for their own PPP loans, they do not count as employees for an applicant's PPP loan calculation or forgiveness. Interim Final Rule, *supra* n.5, at 11, 15.

[17] Interim Final Rule, *supra* n.5, at 17.

[18] In response to lender concerns, the SBA doubled the PPP loan interest rate set in the initial March 31, 2020 guidance. The Act permits an interest rate for PPP loans as high as 4%.

[19] *Paycheck Protection Program: Borrower Application Form*, US Small Bus. Admin., https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Application-3-30-2020-v3.pdf (last visited April 3, 2020) (SBA Form 2483).

[20] *Id.*

[21] Stephanie Ruhle et al., *Banks Warn of 'Utter Chaos' in New Small Business Lending Program*, NBC News (Apr. 2, 2020), https://www.nbcnews.com/business/business-news/banks-warn-utter-chaos-new-small-business-lending-program-n1175336.

[22] H.R. 748 § 1106(e) (2020).

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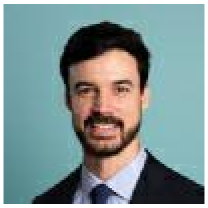

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