

Client Alert

April 2020

SBA April 2, 2020 Mostly Final Rule on the Paycheck Protection Program

The US Small Business Administration (“SBA”) released an immediately effective interim final rule (the “Rule”) on the “Paycheck Protection Program” established under the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act” or “Act”) at the end of the day on April 2, 2020. Due to the escalating concerns regarding economic activity, the SBA dispensed with the 30-day delayed effective date provided in the Administrative Procedure Act.

The Rule outlines the key provisions of the SBA’s implementations of section 1102 and 1106 of the Act that temporarily adds the new Paycheck Protection Program (the “Paycheck Program”) to the SBA’s 7(a) Loan Program and provides for the forgiveness of up to the full principal of, and accrued interest on, qualifying loans under the Paycheck Program.

Paycheck Program Significant Changes from SBA’s Initial Effort:

- Increases interest rate from 50 basis points to 1.00%;
- Eliminates requirement that lenders verify beyond applicant’s provision of specified documentation to support loan amount and certifications;
- Provides SBA will hold harmless any lender for borrowers that fail to comply with program criteria;
- Allows lenders to rely on certifications from borrowers to determine eligibility and use of loan proceeds;
- Fleshes out the process for lender to “request” that the SBA purchase loans as soon as the end of seven weeks after the covered period. The SBA will do so if the lender provides a complete report;
- Leaves it to the banks to prepare promissory notes consistent with Paycheck Program terms; and
- Clarifies what otherwise eligible parties may not participate in the Paycheck Program.

CARES Act and the Paycheck Program

The \$2 trillion CARES Act stimulus package allocates \$349 billion to guarantee loans for “small businesses”¹ and certain nonprofit organizations through the SBA 7(a) loan program. The CARES Act creates a new Paycheck Program for the covered period of February 15, 2020 until June 30, 2020. Congress has the authority to increase the covered period until the end of 2020 if the need should arise due to the pandemic. The UST and SBA anticipate that the funding cap will be reached quickly, and encourages applicants to apply as soon as possible. Separately, however, the Secretary of Treasury has announced the Administration’s intention to seek supplemental funding for the Paycheck Program.

¹ “Small Business” is defined with reference to the Small Business Act and subject to SBA’s affiliation rules.

Characteristics of the Paycheck Program

While the Paycheck Program is still considered a 7(a) loan, loans made during this covered period will have different requirements and features than that of a traditional 7(a) loan. Loans under the Paycheck Program are unsecured, with no collateral or personal guarantees in contrast with a traditional 7(a) loan. The maximum loan amount to each business is equal to the lesser of \$10 million, or the average monthly payroll costs from the last twelve months of the borrower multiplied by 2.5 and then adding any outstanding amount under an Economic Injury Disaster Loan (“EIDL”) that was made between January 31, 2020 and April 3, 2020. New businesses may calculate the monthly payroll average as of January 1, 2020 through February 29, 2020 and highly seasonal businesses may calculate the average using the 12 weeks beginning on February 15, 2019, or from March 1, 2019 to June 30, 2019. The Rule provides that the interest rate will be a 1.00% fixed rate (up from 50 bps in information provided by SBA earlier this week, but down from the 4.00% originally proposed), with a maturity date of two years. There are no prepayment penalties or fees.

Small businesses and sole proprietorships can apply for and receive loans under the Paycheck Program starting today, April 3, 2020, through already eligible lenders. Each applicant can only file for one loan under the Paycheck Program.

Lenders will be compensated by the SBA based on the balance of the financing outstanding at the time of the final disbursement:

- Loans \$350,000 and under: 5.00%
- Loans greater than \$350,000 to \$2 million: 3.00%
- Loans greater than \$2 million: 1.00%

Lenders may also use agents to help facilitate the making of the loans. The agent’s fees will be paid out of the lenders fees as stated below:

- Loans \$350,000 and under: 1.00%
- Loans greater than \$350,000 to \$2 million: .50%
- Loans greater than \$2 million: .25%

We strongly encourage lenders to verify that applicants have not used an agent to “facilitate” or assist with the loan request.

Applicable Uses for Paycheck Program Funds

The borrower will be able to use the proceeds of the funds for the following:

- Payroll costs, including benefits;
- Interest on mortgage obligations, incurred before February 15, 2020, but not mortgage prepayments or principal payments;
- Rent, under lease agreements in force before February 15, 2020;
- Utilities, for which service began before February 15, 2020;
- Interest payments on any other debt obligations that were incurred before February 15, 2020; and
- Refinancing an SBA EIDL loan made between January 31, 2020 and April 3, 2020 (with certain additional limitations).

At least seventy five percent (75%) of the Paycheck Program loan proceeds must be used for payroll costs. Payroll costs include:

- Salary, wages, commissions, or tips (capped at \$100,000 on an annualized basis for each employee);

- Employee benefits including costs for vacation, parental, family, medical, or sick leave; allowance for separation or dismissal; payments required for the provisions of group health care benefits including insurance premiums; and payment of any retirement benefit;
- State and local taxes assessed on compensation; and
- For a sole proprietor or independent contractor: wages, commissions, income, or net earnings from self-employment, capped at \$100,000 on an annualized basis for each employee.

Payroll costs exclude:

- Any compensation to employees whose principal residence is outside of the United States
- Compensation for any employee above \$100,000;
- Federal employment taxes between February 15, 2020 and June 30, 2020;
- Qualified family and sick leave which has a credit is allowed under the Families First Coronavirus Response Act; and
- Expenses paid to independent contractors (because an independent contractor can separately apply under the Paycheck Program).

We note that the rule creates an inconsistency by defining payroll taxes to be excluded from the calculation of federal employment taxes imposed between February 15, 2020 and June 30, 2020, including both the employer and employee share of FICA. Yet, payroll costs are based on “the last 12 months.” The lender’s obligation is to confirm the amount of average payroll costs for the prior calendar year. Moreover, the rule consistently refers to “annual payroll.” We assume the intent was to exclude such taxes in calculating payroll costs and the reference to the dates in the document are a “bust.”

If the applicant uses the funds for unauthorized purposes, the SBA will direct the applicant to repay those amounts. If the applicant knowingly use the funds for unauthorized purposes, the applicant will be subject to additional liability such as charges for fraud. If one of the applicant’s shareholders, members, or partners uses the funds for unauthorized purposes, the SBA will have recourse against the shareholder, member, or partner for the unauthorized use.

Paycheck Program Loan Forgiveness

The Paycheck Program provides for loan forgiveness for a portion of the loan based on certain expenses of the borrower paid during the eight weeks after the loan origination. The forgiveness amount can be up to the full principal amount of the Paycheck Program loan and all accrued interest. The forgiveness is based on the sum of (i) payroll costs plus (ii) payment of interest on a mortgage plus (iii) rent and plus (iv) utility payments over the eight week period following the date of the loan. The mortgage, lease and utility service agreements must all have been in place on February 15, 2020 to qualify. Note that while interest payments on any other debt obligations that were incurred before February 15, 2020 is listed as an acceptable use of the funds, this use is not enumerated with respect to forgiveness. The available forgiveness is reduced if the number of employees and the amount of employee compensation declines during the course of the loan. The applicant has until June 30, 2020 to restore its full-time employment and salary levels for any changes made between February 15, 2020 and April 26, 2020 in order to avoid a reduction of the forgiveness amount.

The applicant will request the forgiveness amount from the lender servicing the loan. The forgiveness request must include documentation verifying the number of full-time equivalent employees and pay rates, as well as the payments on eligible mortgage, lease, and utility obligations. The applicant must certify in good-faith that the documents are true and that the funds were used for the proper purposes. Although not discussed in the Rule, SBA guidance earlier this week indicated that the lender must make a forgiveness decision within sixty (60) days of the request from the applicant. The Rule indicates that additional guidance will be issued on loan forgiveness.

A lender cannot sell a Paycheck Program loan on the secondary market until the loan forgiveness portion has been calculated. The SBA is looking to automate the calculation on the forgiveness amount in order for the SBA to quickly pay the lender the forgiveness portion and to allow them to sell the remainder of the loan on the secondary market. The SBA will not collect any fee for any guarantee sold into the secondary market and will issue additional guidance regarding any advance purchase for loans sold in the secondary market.

Lenders may request that the SBA purchase the expected forgiveness amount of a Paycheck Program loan or pool of Paycheck Program loans at the end of week seven of the covered period. The expected forgiveness amount is the amount of loan principal the lender reasonably expects the borrower to expend on payroll costs, covered mortgage interest, rent, and utility payments during the eight-week period after the loan disbursement. In order to submit a Paycheck Program loan or pool of Paycheck Program loans for advance purchase, the lender is required to submit a report requesting advance purchase with the expected forgiveness amount to the SBA. Among other items, the report must include a detailed narrative explaining assumptions used in determining the expected forgiveness amount, the basis for those assumptions, alternative assumptions considered and why those alternative assumptions were not used, borrower-provided documentation used to determine the expected forgiveness amount, and any additional information the SBA may require to determine whether the expected forgiveness amount is reasonable. The SBA will purchase the expected forgiveness amount of the Paycheck Program loan(s) within 15 days of the date on which the SBA receives a complete report that demonstrates the reasonableness of the expected forgiveness amount.

The Rule provides that lenders can rely on information provided by the borrower with respect to forgiveness. Lenders do not need to conduct verification if the borrower submits documentation supporting its request for loan forgiveness and attests that it has accurately verified the payments for eligible costs. The SBA will hold harmless any lender that relies on such borrower documents and attestation from a borrower. While this reduces liability concerns of lenders under the program, the lender's reporting requirements for submission to the SBA require assumptions and explanation from the lender as to the calculation of forgiveness. Together with the fact that additional guidance will be issued on forgiveness, lenders should gather as much information as possible when taking the initial loan application and before disbursing funds to support their subsequent conclusions as to forgiveness.

Lenders qualified to lend under the Paycheck Program

Lenders already authorized to make loans under the existing SBA program are automatically authorized to provide loans under the Paycheck Program subject to accepting the terms and conditions established by the UST. The following types of lenders have been determined by the SBA and UST to be eligible to make PPP loans unless they are currently designated in Troubled Condition or are subject to a formal enforcement action with respect to unsafe or unsound lending practices by the lender's primary formal regulator:

- Any federally insured depository institution or any federally insured credit union;
- Any Farm Credit System institution as defined in 12 USC 2002(a) that applies the requirements under the Bank Secrecy Act and its implementing regulations (collectively, "BSA"); and
- Any depository or non-depository financing provider that originates, maintains, and services business loans or other commercial financial receivable and participation interests; applies the requirements under the BSA; has been operating since at least February 15, 2019, and has originated, maintained, and serviced more than \$50 million in loans, or is a service provider to any insured depository institution that has a contract to support such institution's lending activities as a regulated bank service company and is in good standing with the appropriate Federal banking agency.

Lenders meeting the criteria outlined above will automatically be qualified upon transmission of SBA Form 3506 (CARES Act Section 1102 Lender Agreement), which is expected to be posted on the SBA and

Treasury websites by the time this alert is released, along with the [SBA Form 2484 \(Lender Application for Loan Guaranty\)](#) that lenders must submit electronically to receive the 7(a) guaranty. The SBA Form 2484 requires lenders to certify that they have complied with the requirements of the Paycheck Program and verified that the borrower is entitled to the requested loan amount based on adequate documentation.

Streamlined Loan Diligence Procedures

The SBA has announced that it will relax certain procedures in the loan origination diligence period to get money to borrowers faster. The SBA has published the Paycheck Protection Program Application Form (Form 2843) for the applicant. The SBA will soon publish the Form 2844 that lenders must use in order to receive an SBA loan number. The SBA will continue to use their existing forms (form 1919 and 1920) for loan diligence for the time being, but will abbreviate the amount of information required through posted guidance.

The applicant will need to complete the Paycheck Program loan application and submit the application with the required documentation to the lender. This application must be processed by the lender by June 30, 2020. The applicant must submit such documentation as is necessary to establish eligibility such as payroll processor records, payroll tax filings, or Form 1099-MISC, or income and expenses. For applicants that do not have any such documentation, the applicant must provide other supporting documentation, such as bank records, sufficient to demonstrate the qualifying payroll amount. Applicants may use e-signature or e-consents for the application regardless of the number of owners.

Underwriting Requirements

Other than reviewing the [Paycheck Program Application Form](#), lenders are required to:

- Confirm receipt of borrower certifications contained in the Paycheck Program Application Form;
- Confirm receipt of information demonstrating that a borrower had employees for whom the borrower paid salaries and payroll taxes on or around February 15, 2020;
- Confirm the dollar amount of average monthly payroll costs for the preceding calendar year by reviewing the payroll documentation submitted with the borrower's application; and
- Follow applicable BSA requirements.

Federally insured depository institutions and credit unions should continue following existing BSA protocols when making Paycheck Program loans to new customers who are eligible borrowers. Paycheck Program loans for existing customers will not require re-verification under BSA requirements, unless otherwise indicated by an institutions risk-based approach to BSA compliance.

Lenders that are not presently subject to the requirements of the BSA should, prior to engaging in Paycheck Program lending activities, establish an anti-money laundering ("AML") compliance program equivalent to that of a comparable federally regulated institution. Such programs should include a customer identification program ("CIP"), which includes identifying and verifying Paycheck Program borrowers' identities (e.g., confirming date of birth, address, and taxpayer identification numbers), and are required to follow applicable beneficial ownership information collection requirements for companies. If available, alternative lenders may rely on the CIP of a federally insured depository institution or credit union with an established CIP as part of its AML program. Such entities are also expected to identify and report suspicious activity to the US Department of the Treasury's Financial Crimes Enforcement Network ("FinCEN").

Borrowers are expected to submit documentation as is necessary to establish eligibility such as payroll processor records, tax filings, or, for borrowers that do not have standard documentation, the borrower must provide other supporting documentation, such as bank records, to demonstrate the qualifying payroll amount. Lenders do not need to conduct any verification for borrower provided documentation if the borrower attests that it has accurately verified the payments for eligible costs. The SBA will hold harmless

any lender that relies on such borrower documents and attestation.

Qualified Borrowers

The Paycheck Program applies to businesses who qualify as small business concerns under the Small Business Act, tax-exempt not-for-profits under 501(c)(3), tax-exempt veterans organizations under 501(c)(19) and Tribal business concerns under 31(b)(2)(c) of the Small Business Act that were in operation on February 15, 2020 and had employees or independent contractors. The Paycheck Program covers businesses with 500 or fewer employees whose principal place of residence is in the United States, or businesses that operate in certain industries and meet the applicable SBA employee-based size standards for that industry. Sole proprietors and the self-employed are also eligible. The applicant must certify in good faith that the business meets all requirements for the loan and will use the proceeds for their applicable purposes.

An applicant's employee count must include the employees of their affiliates as well. The SBA affiliation rules remain mostly unchanged by the CARES Act. However, the Paycheck Program waives the application of the affiliation rules for three types of applicants:

1. Any business concern with no more than 500 employees and that is assigned a NAICS code beginning with 72;
2. Any business concern operating as a franchise that is assigned a franchise identified code by the SBA; and
3. Any business concern that receives financial assistance from a company licensed under section 301 of the Small Business Investment Act of 1958.

The size standards aggregate all entities that share 50% common control under traditional SBA 7(a) affiliation rules. Hospitality and restaurant businesses, franchises, and recipients of Small Business Investment Company ("SBIC") investments have statutory exceptions. Franchises and hospitality businesses with multiple locations are tested by a 500 employee per location standard. Any business that receives SBIC financial assistance satisfies the size restriction. The SBA intends to promptly issue additional guidance with regard to the applicability of affiliation rules at 13 CFR §§ 121.103 and 121.301 to the Paycheck Program.

The Paycheck Program does not require the standard "Credit Elsewhere" test that traditional 7(a) loans require. This means the borrower does not have to prove that they are unable to receive credit from another institution in order to qualify for the Paycheck Program. The borrower must certify, in good faith, that their business requires the loans to continue operation during the pandemic, that the funds will be used for the stated purpose of payroll preservation and maintaining operation, and that the borrower does not have any other application pending under the Paycheck Program.

Ineligible Businesses

The SBA has stated that business that otherwise would be eligible for the Paycheck Program will be ineligible due to their industry. A list of ineligible industries can be found at [SBA.gov](https://www.sba.gov). An applicant is also ineligible if they are engaged in illegal activity, have delinquent SBA or other federal agency guaranteed loans or have defaulted on any such SBA or other federal agency guaranteed loans within the last seven years and "caused a loss to the government," or if an owner of the business is currently or has been involved in criminal proceedings.

Subsidy and Deferment for Existing 7(a) Loans

The SBA is currently expanding the deferment procedures for both existing 7(a) loans and new loans under the Paycheck Program. The SBA will pay the principal, interest and any fees on certain existing 7(a) loans for a six-month period starting on the next payment due date of the loan. Loans currently in deferment will include an additional six months of payment by the SBA beginning with the next payment. All payments under the Paycheck Program are deferred for six (6) months. However, interest will accrue during this deferment period.

Interplay of EIDL and Paycheck Program Loan

If an applicant received an SBA EIDL loan from January 31, 2020 through April 3, 2020, the applicant can apply for a Paycheck Program loan. If the EIDL loan was not used for payroll costs, it does not affect the applicant's eligibility for a Paycheck Program loan. If the applicant's EIDL loan was used for payroll costs, the applicant's Paycheck Program loan must be used to refinance the EIDL loan. Proceeds from any advance up to \$10,000 on the EIDL loan will be deducted from the loan forgiveness amount on the Paycheck Program loan.

Contacts

Peter G. Weinstock

pweinstock@HuntonAK.com

Heather Archer Eastep

heastep@HuntonAK.com

Patrick Boot

pboot@HuntonAK.com

Dean Elazab

delazab@HuntonAK.com

© 2020 Hunton Andrews Kurth LLP. Attorney advertising materials. These materials have been prepared for informational purposes only and are not legal advice. This information is not intended to create an attorney-client or similar relationship. Please do not send us confidential information. Past successes cannot be an assurance of future success. Whether you need legal services and which lawyer you select are important decisions that should not be based solely upon these materials.