

ALERTS

SBA Issues Regulations on Paycheck Protection Program, Narrowing Eligibility and Providing More Details

April 3, 2020

On April 2, 2020, the Small Business Administration (“SBA”) promulgated an Interim Final Rule^[1] implementing the Paycheck Protection Program (“PPP”) contemplated in the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”), discussed in our prior initial *Alert* and supplemental *Alert*. The Interim Final Rule sets forth important updates on how the SBA will implement the PPP when SBA-approved lenders begin issuing PPP loans today.

In addition to clarifying and expanding upon existing details of the PPP, the Interim Final Rule makes several material changes. Perhaps most importantly, in addition to the CARES Act requirement that an applicant must have no more than 500 employees (on an aggregate basis with its affiliates), the Interim Final Rule also indicates that an applicant must qualify as a “small business concern” under the Small Business Act. Under existing SBA regulations, whether a business is a “small business concern” depends on certain “size standards” that have been established for each type of economic activity, or industry, generally under the North American Industry Classification System (“NAICS”).^[2] Depending on the industry, the NAICS measures size by either total number of employees or total “receipts” (defined generally as all revenue in whatever form received or accrued from whatever source, subject to certain limited adjustments). Accordingly, contrary to a plain language reading of the CARES Act, many businesses with 500 or fewer employees will not be eligible to receive a PPP loan, depending on the business’ annual revenue.

Moreover, the Interim Final Rule makes clear that entities conducting businesses that would ordinarily be ineligible for SBA 7(a) loans will also be ineligible for the PPP, other than those nonprofit organizations authorized under the CARES Act. Such businesses include (1) most financial businesses primarily engaged in the business of lending; (2) most passive businesses owned by developers and landlords that do not actively use or occupy the assets acquired or improved with the loan proceeds; (3) life insurance companies; (4) pyramid sale distribution plans; (5) businesses deriving more than one-third of gross annual revenue from legal gambling activities; (6) private clubs and businesses which limit the number of memberships for reasons other than capacity; (7) businesses primarily engaged in political or lobbying activities; and (8) speculative businesses.

[3]

This *Alert* summarizes the SBA's Interim Final Rule and provides an overview of key changes to the PPP from the Department of the Treasury's ("Treasury") initial guidance published on March 31, 2020 (discussed in our supplemental *Alert*).

Overview of Key Provisions of the Interim Final Rule

Indemnification for Lenders

Under the PPP, the SBA is authorized to guarantee up to \$349 billion in loans to small businesses through June 30, 2020. The Interim Final Rule indicates that, because the intent of the CARES Act is to provide immediate and expeditious relief to such small businesses, the SBA will allow its approved lenders to rely on borrower certifications and specified documents to determine PPP loan eligibility and to determine the amount of loan proceeds for which the borrower qualifies. Notably, the Interim Final Rule relieves lenders of any liability for providing a PPP loan to any borrower that factually does not meet the SBA's criteria, but fraudulently certifies that it does.

Information for Borrowers

Eligibility

The Interim Final Rule indicates that eligible borrowers must (i) have 500 or fewer employees *whose principal place of residence is in the United*

States[4]; or (ii) if applicable, meet the size standard in number of employees established by the SBA for the industry in which the applicant operates. To determine number of “employees,” potential borrowers should include those hired on a full-time, part-time or any other basis, but not independent contractors since they have the ability to apply for a PPP loan on their own. The number of an applicant’s employees must also include the employees of all of its affiliates, in accordance with the SBA’s affiliation rules, unless the CARES Act specifically waives such affiliation rules, which it did for those businesses (i) in the “accommodation and food services” sector; (ii) operating as a franchise; or (iii) receiving financial assistance from a small business investment company. The Interim Final Rule states that the SBA intends to promptly issue additional guidance with regard to the applicability of affiliation rules to PPP loans.

In addition, the Interim Final Rule requires that potential borrowers must (i) qualify as either (a) a “small business concern” (as discussed above); or (b) a 501(c)(3) tax-exempt nonprofit organization, a 501(c)(19) tax-exempt veterans organization, a tribal business concern, or any other business[5]; (ii) have been in operation on Feb. 15, 2020; and (iii) have either (a) had employees for whom it paid salaries and payroll taxes or (b) paid independent contractors, as reported on a Form 1099-MISC. Also as discussed above, an applicant must not operate a business that would ordinarily be ineligible for SBA 7(a) loans, except in the case of one of the foregoing tax-exempt entities.

Finally, a potential borrower is ineligible for a PPP loan if, among other things, such applicant (i) is engaged in any illegal activity under federal, state or local law; (ii) is a household employer (i.e., an individual who employs a nanny or housekeeper for household purposes)[6]; (iii) has an owner with a 20% or greater equity ownership interest who is incarcerated, on probation, on parole presently subject to an indictment, criminal information, arraignment or other means by which formal criminal charges are brought in any jurisdiction, or has been convicted of a felony within the last five years; or (iv) any business owned or controlled by it or any of its owners has ever received an SBA loan or a loan from any other federal agency that is currently delinquent or has defaulted within the last seven years and caused a loss to the government.

As discussed in our prior *Alert*, individuals operating under a sole proprietorship, as an independent contractor or who are self-employed are also eligible to apply for a PPP loan, so long as such individual’s

business was in operation on Feb. 15, 2020. Borrowers must submit such documentation as is necessary to establish eligibility, such as payroll processor records, payroll tax filings, a Form 1099-MISC or income and expenses from a sole proprietorship. For borrowers who do not have such documentation, such borrowers must submit other supporting documentation, such as bank records, sufficient to demonstrate the qualifying payroll amount.

Loan Size

PPP loans may not exceed the lesser of (i) \$10 million or (ii) 2.5 times the borrower's average monthly payroll costs during the one-year period before the date on which the Loan is made. Potential borrowers may only apply for one PPP loan; thus, it is advised that potential borrowers apply for the maximum amount available to it. To calculate the maximum amount available under a PPP loan, potential borrowers should:

1. Aggregate payroll costs^[7] from the last twelve months^[8] for employees whose principal place of residence is the United States. Note that independent contractors do not qualify as an employee for purposes of this calculation. Independent contractors may apply for a PPP loan individually.
2. Subtract any compensation paid to an employee in excess of an annual salary of \$100,000 and/or any amounts paid to an independent contractor or sole proprietor in excess of \$100,000 per year.
3. Calculate average monthly payroll costs by dividing the amount from Step 2 by 12.
4. Multiply the average monthly payroll costs from Step 3 by 2.5.
5. Add the outstanding amount of an Economic Injury Disaster Loan ("EIDL") made between Jan. 31, 2020 and April 3, 2020, less the amount of any "advance" under such EDIL, as it does not have to be repaid.

Loan Terms, Including Forgiveness

Contrary to the Treasury's initial guidance, which indicated that the interest rate on PPP loans will be 0.50%, the Interim Final Rule provides for an interest rate of 1.00%. However, the maturity will remain two years. Interest and principal will become due on the date six months after the loan is disbursed, but interest will accrue during this six-month period.

Borrowers will not be required to provide a personal guarantee or put up collateral in order to obtain a PPP loan. Borrowers will not owe any up-front fees to the SBA.

Borrowers may use PPP loan proceeds for (i) payroll costs; (ii) costs related to the continuation of group health care benefits during periods of paid sick, medical or family leave, and insurance premiums; (iii) mortgage interest payments (but not mortgage prepayments or principal payments); (iv) rent payments; (v) utility payments; (vi) interest payments on any other debt obligations that were incurred before Feb. 15, 2020; and/or (vii) refinancing an EIDL loan made between Jan. 31, 2020 and April 3, 2020.

Borrowers using PPP loan proceeds for purposes other than those outlined above will be required to repay any amounts used for such unauthorized purposes. Additional liability will follow for those that knowingly use PPP loan proceeds for unauthorized purposes, including being charged with fraud. If one of a borrower's shareholders, members or partners uses PPP loan proceeds for unauthorized purposes, the SBA will have recourse against the shareholder, member or partner for the unauthorized use.

PPP loans may be forgiven in whole or in part, up to the full principal amount of the loan and any accrued interest. Borrowers, however, must use PPP loan proceeds for forgivable purposes and maintain employment and compensation levels. The Interim Final Rule states that the actual amount of loan forgiveness will depend, in part, on the total amount of (i) payroll costs; (ii) payments of interest on mortgage obligations incurred before Feb. 15, 2020; (iii) rent payments on leases dated before Feb. 15, 2020; and (iv) utility payments under service agreements dated before Feb. 15, 2020, in each case, over the eight-week period following the date of the loan.^[9] However, the SBA has clarified that not more than 25% of the loan forgiveness amount may be attributable to non-payroll costs.^[10] For purposes of loan forgiveness, however, the potential borrower will have to document the proceeds used for payroll costs in order to determine the amount of loan forgiveness.

Application Process

The Interim Final Rule makes clear that PPP loans will be issued on a first-come, first-served basis, with no applicant being eligible to receive more

than one loan. To apply, a potential borrower must submit (i) an application form, which can be found [here](#); and (ii) payroll documentation directly to an SBA-approved lender. A potential borrower may use e-signatures and e-consents regardless of how many owners it has.

To apply, an authorized representative of the applicant must certify, in good faith, that (i) the business was in operation on Feb. 15, 2020 and had employees for whom it paid salaries and payroll taxes or paid independent contractors, as reported on a Form 1099-MISC; (ii) current economic uncertainty makes this loan request necessary to support ongoing operations of the business; (iii) PPP loan proceeds will be used to retain workers and maintain payroll or make mortgage interest payments, lease payments and utility payments; (iv) they understand that the federal government may hold them legally liable if the funds are knowingly used for unauthorized purposes; (v) documentation verifying the number of full-time equivalent employees on payroll as well as the dollar amounts of payroll costs, covered mortgage interest payments, covered rent payments, and covered utilities for the eight-week period following this loan will be provided to the lender; (vi) they understand that loan forgiveness will be provided for the sum of documented payroll costs, covered mortgage interest payments, covered rent payments and covered utilities, and that 25% of the forgiven amount may be for non-payroll costs; (vii) during the period beginning on Feb. 15, 2020 and ending on Dec. 31, 2020, the potential applicant has not and will not receive another loan under the PPP; (viii) the information provided in the application and supporting documentation is true and accurate in all material respects, and they understand that knowingly making a false statement to obtain a guaranteed loan from the SBA is punishable under the law; and (ix) they acknowledge that the lender will confirm the eligible loan amount using tax documents submitted, and affirm that such tax documents are identical to those submitted to the Internal Revenue Service.

If a potential applicant received an EIDL loan between Jan. 31, 2020 and April 3, 2020, it can still apply for a PPP loan.^[11] If the EIDL loan was not used for payroll costs, it does not affect a potential applicant's eligibility for a PPP loan, but if the EIDL loan was used for payroll costs, a PPP loan must be used to refinance such EIDL loan. Proceeds from any EIDL loan advance, up to \$10,000, will be deducted from the loan forgiveness amount on the PPP loan. Still, potential applicants must use at least 75% of a PPP loan for payroll costs (a refinanced EIDL loan will be included in

the total PPP loan amount for purposes of determining the percentage of proceeds used for payroll costs).

Information for Lenders

Eligibility

All lenders that have previously been approved to lend under the SBA's 7(a) loan program are automatically approved to make PPP loans on a delegated basis. Additionally, the CARES Act authorizes the SBA to extend the authority to make PPP loans to additional lenders whom the SBA deems to have the necessary qualifications to process, close, disburse and service loans made with the SBA guarantee.

The SBA has indicated that it plans to authorize such additional lenders to make PPP loans, and has indicated that the following lenders^[12] would meet the criteria to lend PPP loans: (i) any federally insured depository institution or any federally insured credit union (automatically qualified upon submission of a SBA Form 3506); (ii) any Farm Credit System institution (other than the Federal Agricultural Mortgage Corporation) that applies the requirements under the Bank Secrecy Act and its implementing regulations (collectively, the "BSA") as a federally regulated financial institution, or functionally equivalent requirements that are not altered by the Interim Final Rule (automatically qualified upon submission of a SBA Form 3506); and (iii) any depository or non-depository financing provider that originates, maintains and services business loans or other commercial financial receivables and participation interests; has a formalized compliance program; applies the requirements under the BSA as a federally regulated financial institution, or the BSA requirements of an equivalent federally regulated financial institution; has been operating since at least Feb. 15, 2019 and has 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 any insured depository institution that has a contract to support such institution's lending activities and is in good standing with the appropriate federal banking agency. While the Interim Final Rule indicates that qualified eligible lenders described in the foregoing clauses (i) and (ii) will be automatically approved upon transmission of a "CARES Act Section 1102 Lender Agreement" (i.e., SBA Form 3506), no further guidance is given for those eligible lenders described in clause (iii) above.

Underwriting Requirements

In terms of underwriting, the Interim Final Rule provides that each lender must confirm (i) that it has received borrower certifications contained in the SBA's PPP application form; (ii) that it has received information demonstrating that the borrower had employees for whom the borrower paid salaries and payroll taxes on or around Feb. 15, 2020; and (iii) the dollar amount of average monthly payroll costs for the preceding calendar year.

Lenders must also follow applicable BSA requirements. Federally insured depository institutions and federally insured credit unions may continue to follow their existing BSA protocols; PPP loans for existing customers will not require re-verification under applicable BSA requirements, unless otherwise indicated by the institution's risk-based approach to BSA compliance. Entities that are not presently subject to the requirements of the BSA should establish an anti-money laundering ("AML") compliance program equivalent to that of a comparable federally regulated institution. [13]

A lender's underwriting obligations are limited to the above and reviewing an applicant's PPP application form and supporting documents (see above for qualifying supporting documentation). As noted above, lenders need not independently verify the representations on any supporting documentation that borrowers submit with respect to loan forgiveness and will be held harmless to the extent that it relies on such documentation and corresponding attestation from a borrower. Similarly when evaluating a borrower's eligibility, lenders need not require applicants to be unable to obtain credit elsewhere.

Provided the lender complies with all of the forgoing, the SBA will guarantee 100% of each PPP loan.

Fees

The Interim Final Rule indicates that the SBA will cover any lenders fees associated with processing PPP loans up to (i) 5.00% for loans not more than \$350,000; (ii) 3.00% for loans more than \$350,000 and less than \$2 million; and (iii) 1.00% for loans not less than of at least \$2 million.[14]

Additionally, lenders will not owe the SBA any annual service fee, subsidy recoupment fee or fee resulting from the sale of any guarantee sold into the secondary market. If an agent is employed to assist a borrower, such

associated fees will be paid by the lender out of any fees it receives from the SBA. Agents may not collect any fees from the borrower or collect a portion of the PPP loan proceeds. Agent fees may not exceed (i) 1.00% for loans not more than \$350,000; (ii) 0.50% for loans more than \$350,000 and less than \$2 million; and (iii) 0.25% for loans of at least \$2 million.

Forgiveness

The Interim Final Rule explains that a lender may request that the SBA purchase the expected forgiveness amount of a PPP loan or a pool of PPP loans at the end of the seventh week of the covered period. To make such a request, a lender should submit to the SBA a report requesting such advance purchase, specifying the expected forgiveness amount^[15] and including (i) the borrower's PPP application form (i.e., SBA Form 2483) and any supporting documentation; (ii) the PPP lender's application form for 7(a) loan guaranty (i.e., SBA Form 2484) and any supporting documentation; (iii) a narrative explanation of the lender's calculation of the expected forgiveness amount, including the basis of such calculation, alternative calculations considered and an explanation of why such alternatives were not used; (iv) any information obtained from the borrower since the loan was disbursed that the lender used to determine the expected forgiveness amount, which should include the same documentation required to apply for loan forgiveness; (v) other payment documentation; and (vi) any other additional information the SBA may require in assessing the reasonableness of the expected forgiveness amount. Within 15 days of receiving a report that demonstrates a reasonable expected forgiveness amount, the SBA will repurchase such loan or pool of loans.

Secondary Market

PPP loans may be sold into the secondary market, but only after the loan has been fully disbursed. This may be done at a premium or at a discount to par value. The SBA will issue additional guidance with respect to any advance purchase for loans sold into the secondary market.

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[1] Available [here](#).

[2] Such size limitations, broken down by industry, can be found at 12 C.F.R. § 121.201.

[3] See 13 CFR 120.110 and the SBA's Standard Operating Procedure (SOP) 5010, Subpart B, Chapter 2. Of note, while the regulation refers to "[f]inancial businesses primarily engaged in the business of lending, such as banks, finance companies, and factors," the SOP includes within the category of "Businesses Engaged in Lending" a wider range, i.e., "businesses primarily engaged in lending, investments, or to an otherwise eligible business engaged in financing or factoring." Within that broader category, the SOP lists "Investment Companies" (undefined) as among the ineligible, but further indicates that "A business engaged in providing the services of a financial advisor on a fee basis is eligible provided they do not use loan proceeds to invest in their own portfolio of investments."

[4] Applying the 500 employee threshold to only U.S. employees appears to be a change from the CARES Act and the Treasury's prior guidance.

[5] We assume that this reference to "any other business" should not be read literally, as it would undo all of the other preceding restrictions. Instead, we assume that it was meant to refer to other tax-exempt businesses, similar to the list that immediately precedes that clause.

[6] Although the CARES Act did not exempt household employers, the SBA and Treasury determined that such employers are ineligible because they are not "businesses."

[7] Payroll costs consist of employee salaries, wages, commissions or similar forms of compensation; cash tips or the equivalent, which must be based on past records or a good-faith estimate; vacation, parental, family, medical or sick leave payments; severance payments; employee benefits payments consisting of group health care coverage, insurance premiums and retirement payments; state and local employment taxes; and, for independent contractors and sole proprietorships, wages, commissions, income, net earnings or similar forms of compensation from self-employment. Payroll costs *do not* include compensation for employees principally residing outside of the United States; individual compensation exceeding \$100,000 annually (prorated); federal employment taxes imposed or withheld between Feb. 15, 2020 and June 30, 2020, which would include both the employer's and the employee's FICA share;

Railroad Retirement Act taxes and income taxes required to be withheld; and qualified sick and family leave wages for which a credit is allowed under sections 7001 and 7003 of the Families First Coronavirus Response Act.

[8] Although this is consistent with the CARES Act, this is not consistent with the current SBA application form, which asks non-seasonal businesses that commenced operating prior to 2019 to use their average monthly payroll during 2019.

[9] Because the Interim Final Rule does not go into any detail on the calculation for determining the loan forgiveness amount, it is unclear whether it represents any change in this regard. Based on the CARES Act and the Treasury's previous guidance, the loan forgiveness amount would equal the total payroll costs incurred and payments made as described during the eight-week period, but would be reduced by (i) any reduction in the average number of monthly full-time equivalent ("FTE") employees during the eight-week period as compared to the average number of monthly FTE employees during, at the borrower's election, either (a) the period between Feb. 15, 2019 and June 30, 2019 or (b) the period between Jan. 1, 2020 and Feb. 29, 2020; and (ii) the amount of any reduction in total salary or wages of any employee during the eight-week period that exceeds 25% of that employee's total salary or wages during their most recent full quarter of employment.

[10] The prior Treasury guidance had indicated this would likely be the case.

[11] While not entirely clear, the Interim Final Rule seems to indicate that a business obtaining an EIDL loan after April 3, 2020 would not be eligible to apply for a PPP loan.

[12] Such lenders are not eligible if they are currently designated in Troubled Condition by their primary federal regulator or are subject to a formal enforcement action with their primary federal regulator that addresses unsafe or unsound lending practices.

[13] Such a program may include a customer identification program ("CIP"), which includes identifying and verifying their PPP borrowers' identities (including, e.g., date of birth, address and taxpayer identification number), and, if that PPP borrower is a company, following any applicable beneficial ownership information collection requirements. Alternatively, if

available, entities may rely on the CIP of a federally insured depository institution or federally insured credit union with an established CIP as part of its AML program. In either instance, entities will also generally have to identify and report certain suspicious activity to the Treasury's Financial Crimes Enforcement Network ("FinCEN").

[14] While prior Treasury guidance had indicated a loan in the amount of \$2 million would be subject to a 3% processing fee, the Interim Final Rule indicates it would be subject to a 1% fee, which is consistent with the CARES Act.

[15] The expected forgiveness amount may not exceed the total amount of principal on the PPP loan or pool of PPP loans.

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