

April 3, 2020

## **CARES Act UPDATE: SBA Issues Interim Final Rule for Paycheck Protection Program**

This memorandum updates our previously published memoranda concerning the Paycheck Protection Program (“PPP”) under the Small Business Administration’s (“SBA”) Section 7(a) lending program, including our memoranda regarding the CARES Act generally (available [here](#)) and how the CARES Act expands access to the Section 7(a) loan program (available [here](#)).

On the evening of Thursday, April 2, 2020, the SBA issued an interim final rule (“IFR”) regarding implementation of the PPP (available [here](#)), and this morning a final borrower loan application form was published (available [here](#)). The IFR and revised application form clarify certain issues raised under the CARES Act and previously issued guidance on the PPP, although in some respects are contrary to previously issued guidance. This memorandum summarizes certain key aspects of the IFR and revised application form as they relate to such prior guidance.

### **Borrower Considerations**

Among the key updates arising out of the IFR and revised loan application form pertinent to borrowers are the following:

- **First-Come, First-Served.** The IFR expressly states that PPP loans will be made on a first-come, first served basis. Given the anticipated high demand for this program, prospective borrowers should submit their loan applications as soon as possible.
- **Interest Rate.** Contrary to guidance published by the U.S. Treasury earlier this week, all PPP loans will have an interest rate of 1.00%, rather than 0.50%.
- **Eligibility Criteria.**
  - ***Affiliate Aggregation Requirements.*** The IFR does not substantively alter previous guidance on the applicability of the SBA’s affiliate aggregation principles, which require a prospective borrower to aggregate its number of employees with those of its affiliates (and their respective affiliates), subject to waivers or different size tests for accommodations and food services businesses (NAICS code beginning with 72), businesses operating as a franchise and businesses receiving financial assistance from a small business investment company licensed by the SBA (additional information is available [here](#)). However, the IFR states that the SBA “intends to promptly issue additional

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guidance with regard to the applicability of affiliation rules at 13 C.F.R. §§ 121.103 and 121.310 to PPP loans,” without providing further insight into what sort of guidance may be forthcoming.

- *Application Certifications.* The PPP loan application form published by the U.S. Treasury and the SBA earlier this week required applicants and owners of 20% or greater ownership stakes in applicants to make certain certifications regarding the loan and its terms, among other things. While the IFR and revised loan application form have added items that a borrower must certify, the loan application form no longer requires certification by owners of the borrower. The borrower certifies its own eligibility for a PPP loan by making each of these certifications, including to the borrower’s documentation verifying “the number of full-time equivalent employees on the Applicant’s payroll.” Because the onus is on the applicant to verify its eligibility, number of employees and total payroll costs, prospective borrowers and their investors should carefully consider whether affiliate aggregation requirements apply to their circumstances and how that might affect the prospective borrower’s PPP eligibility before making these certifications in the loan application (i.e., prior to applying).
- *Citizenship and Residency Requirement.* The loan application form published earlier this week also required borrowers and their owners of 20% or greater ownership stakes to respond to three questions, including whether each of them is a U.S. Citizen or Lawful Permanent Resident, and noted that if any such person did not so confirm, the loan would be denied, without providing any guidance on how this question should be answered by respondents that are not individuals. The IFR is notably silent on this requirement, however, and the citizenship or residency question has been removed from the revised loan application form. In its place, the revised loan application form now asks the borrower to confirm that the U.S. is the principal place of residence for all of its employees included in its average monthly payroll cost calculation.
- Loan Amounts, Uses and Forgiveness.
  - *Payroll Costs.*
    - Measurement Period. The IFR contains an internal inconsistency when describing how average monthly payroll costs are to be calculated. In one instance, the IFR illustrates a methodology for applicants to calculate payroll costs by aggregating payroll costs “from the last twelve months” (see Section 2(e)(i)). However, in another instance, the IFR instructs lenders to confirm a borrower’s average monthly payroll costs “for the preceding calendar year” (see Section (3)(b)(iii)), and the revised loan application form mirrors this requirement by stating that “most Applicants will use the average monthly payroll for 2019.” While further guidance from the SBA to resolve this inconsistency would be helpful, the revised application form does not refer to the “last twelve months” calculation method. Prospective borrowers should follow

the instructions for calculating payroll costs as indicated in the revised loan application form itself.

- **Independent Contractors.** Although prior guidance was unclear on the point, the IFR expressly provides that independent contractors may not be taken into account by businesses for PPP purposes (including, for example, in calculations of payroll costs) because independent contractors are eligible to apply for their own PPP loans.
- **Federal Employment Taxes.** The IFR confirms the implication in recent guidance that federal employment taxes imposed or withheld between February 15, 2020 and June 30, 2020 are excluded from calculations of payroll costs.
- ***Permitted Uses; Minimum Use of Loan Proceeds for Payroll Costs.*** The IFR adds a new requirement that not less than 75% of loan proceeds be used for payroll costs, and therefore not more than 25% of loan proceeds may be used for non-payroll costs otherwise eligible under the PPP. Borrowers are required to certify in their loan applications that they understand this restriction, and the SBA will direct borrowers who violate this restriction to repay amounts improperly used. We note that the IFR and revised loan application form are somewhat ambiguous on whether loan proceeds may be used for these permitted purposes solely during the eight-week period post-disbursement. However, it is clear that forgiveness is only available in respect of amounts used during this eight-week period.
- ***Loan Forgiveness Limitations.*** While the IFR helpfully confirms that PPP loans will be eligible for forgiveness of up to 100% of the principal loan amount and all accrued interest, it also adds a cap on forgiveness for non-payroll costs equal to 25% of the loan forgiveness amount.
- **Liability for Unauthorized Use of Loan Proceeds.** The IFR provides that borrowers who use loan proceeds for unauthorized purposes will be directed to repay those amounts and may also be subject to additional liability (e.g., fraud) for knowingly using such proceeds for unauthorized purposes. The IFR further provides that owners of a borrower may be held directly liable for their own unauthorized use of loan proceeds.

### **Lender Verification Obligations**

The CARES Act and previous PPP guidance did not provide potential lenders with clarity on their obligations and responsibilities in underwriting loans and processing requests for forgiveness. While the IFR does not definitively address all open points of concern to PPP lenders, it does provide more concrete direction regarding their obligations to review and confirm applicants' eligibility for PPP loans and forgiveness, and also shields lenders from certain liabilities.

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- **Limited Liability for Lenders.** The IFR reaffirms the “hold harmless” provision in the statute by stating that, while lenders are obligated to comply with their duties as set out in the IFR, lenders will be held harmless for a borrower’s failure to comply with PPP terms. In addition, lenders may rely on a borrower’s certification as to its use of PPP loan proceeds and specified documents provided by a borrower to determine a borrower’s eligible loan amount and eligibility for forgiveness.
  - **SBA Lending Criteria.** Lenders need not comply with the SBA’s traditional lending criteria (see 13 CFR § 120.150). Instead, lenders may rely on a borrower’s certifications made in its loan application to determine PPP eligibility.
  - **Underwriting Requirements.** In the underwriting process, lenders must:
    - Confirm each of the following:
      - Receipt of a borrower’s certifications required by the SBA’s loan application form;
      - Receipt of information demonstrating that a borrower had employees for whom it paid salaries and payroll taxes on or around February 15, 2020; and
      - The dollar amount of a borrower’s average monthly payroll costs for the preceding calendar year<sup>1</sup> *by reviewing payroll documentation submitted by the borrower.*
    - Follow applicable Bank Secrecy Act (BSA) requirements.
      - Federally insured depository institutions and federally insured credit unions should continue following their existing BSA protocols. (We note that for existing customers as to which financial institutions have already collected and verified beneficial ownership information, in almost all cases they will only need to confirm with customers that the prior information is accurate and up-to-date.) The IFR states: “PPP loans to existing customers of such institutions will generally not require reverification under BSA requirements.”
      - Entities not subject to the BSA who wish to become PPP lenders should establish anti-money laundering and related compliance programs equivalent to those of a comparable federally regulated institution.

Per the IFR, lenders’ underwriting obligations are limited to those described here and reviewing PPP loan applications.

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<sup>1</sup> As noted above, this is inconsistent with other provisions of the IFR that refer to average monthly payroll for the preceding 12 months.

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- Loan Forgiveness Processing. Lenders are not required to conduct any verification of documentation submitted by a borrower in support of a request for forgiveness so long as the borrower attests that it has accurately verified its eligible payments.

### Ongoing Updates

While the IFR is effective immediately upon its publication in the Federal Register, it is under continuing review and open for public comment, and the SBA may revise it as it deems appropriate. We will continue to monitor any revisions to the IFR and the final rule, when it is published, and provide our clients with timely information on how any revisions may affect their participation (or lack of participation) in the PPP.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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