

Treasury Department Continues to Issue Guidelines for Small Business Paycheck Protection Program

(Update to Flash Report issued on May 4, 2020)

June 8
2020

Introduction

The Coronavirus Aid, Relief, and Economic Security (CARES) Act that was signed into law on March 27, 2020, offers a lifeline to small businesses and sole proprietors (generally those with 500 or fewer employees) in the form of the Paycheck Protection Program (PPP) administered by the U.S. Small Business Administration (SBA). This program initially authorized \$349 billion in forgivable loans, with individual advances based on the size of the small businesses' average payroll, to eligible small businesses that were in operation on February 15, 2020. The program officially launched on April 3, with a termination date of June 30, 2020, or when the funding was depleted, which occurred on April 16, at which time the SBA stopped accepting applications. On April 23, legislation authorizing an additional \$310 billion in PPP funding was signed into law. The SBA began accepting applications for the second round of funding on April 27.

To counter claims that many potential borrowers, particularly those that deal with smaller financial institutions, were disadvantaged in the first round, the U.S. Congress earmarked \$60 billion of the new funding for smaller financial institutions, specifically:

- \$30 billion for loans made by insured depository institutions, including Community Development Financial Institutions (CDFIs) with between \$10 billion and \$50 billion in assets.
- \$30 billion for loans made by institutions with assets of less than \$10 billion.

The SBA also decided to cap the amount of loans a single lender can provide at 10% of the lending pool, or \$60 billion, and announced that between 4 p.m. and 11:59 p.m. on April 29 it would only accept applications from lenders with less than \$1 billion in total assets.

In addition, the SBA issued guidance, just before and after Congressional approval of the additional funds, to make clear that companies applying for coronavirus relief funds must certify that the loans are necessary and that they cannot tap other sources of funding. This provision contradicted previous SBA guidance, and made it unlikely, in the SBA's view, that public companies with access to the capital markets as an alternative funding source would be able to participate in the PPP. The SBA and others have since brought considerable pressure to bear on larger companies that accepted loans in the first round. The SBA has said, however, that a borrower that applied for a PPP loan prior to the issuance of clarification and repaid the loan in full by May 14, 2020, would be deemed to have made the required certification in good faith.

Further, the SBA on April 30 issued guidance that stated that corporate groups should not get more than \$20 million in total loans. This limit applies if businesses are "majority owned, directly or indirectly, by a common parent." The limit was effective immediately for any loan not yet fully disbursed as of April 30. Borrowers that have applied for or received more than \$20 million in loans are required to withdraw or cancel any pending application or approved loan over the limit, according to the guidance. Failure to do so would result in the funds being deemed as used for "unauthorized purposes, and the loan will not be eligible for forgiveness."

In a subsequent rulemaking, the SBA stated that hedge funds and private equity firms, since they are primarily engaged in investment or speculation, were not eligible for PPP loans.

Even with the additional round two allocation, PPP funding will still fall significantly short of the need, based on Federal Reserve Bank of Atlanta President Raphael Bostic's estimate that small businesses could require as much as \$500 billion monthly to operate through the COVID-19 pandemic. Given the significant backlog of small business applicants that were unable to obtain funding in the first round because their applications did not make it through the approval process, new funds were expected to be exhausted in days, not weeks. In fact, some banks cautioned that they expected pending applications alone would deplete the additional funds even before new applications were accepted. However, more than a month after the application process began for the second round of funding, more than \$100 billion remains available. Over time, it has become clear that one contributing factor to the slower than anticipated drawdown of the second tranche of funds (and a reason that some first round borrowers have been reluctant to use funds obtained in the first round) has been concern over the forgiveness process, both the terms and the feasibility of meeting program requirements for forgiveness. Further developments on both points, as discussed below, may

portend some increase in applications, though they likely do not resolve all of the small business industry's concerns.

Both rounds of funding were fraught with operational challenges, many caused by the limited time available to both lenders and the SBA to prepare for the launch of the program, and for lenders and borrowers, the slow rollout of program guidance and regulations, which as noted above, sometimes contradicted earlier directions.

This Flash Report, which we will update periodically as new information becomes available, describes the current status of the PPP, its key provisions, and the questions and challenges lenders still face as they work to serve their small business customers.

Treasury Department Rulemaking and Guidance

Since the inception of the PPP, the SBA has issued 15 Interim Final Rules:

1. Paycheck Protection Program
2. Affiliation Rules
3. Additional Eligibility Criteria and Requirements for Certain Pledges of Loans for the Paycheck Protection Program
4. Promissory Notes, Authorizations, Affiliation, and Eligibility
5. Seasonal Employers
6. Disbursements
7. Requirements – Corporate Groups and Non-Bank and Non-Insured Depository Institution Lenders
8. Nondiscrimination and Additional Eligibility Criteria
9. Extension of Limited Safe Harbor with Respect to Certification Concerning Need for PPP Loan Request
10. Requirements for Loan Increases for Partnerships or Seasonal Employers
11. Eligibility of Certain Electric Cooperatives
12. Treatment of Entities with Foreign Affiliates
13. Second Extension of Limited Safe Harbor with Respect to Certification Concerning Need for PPP Loan and Lender Reporting
14. Requirements – Loan Forgiveness
15. SBA Loan Review Procedures and Related Borrower and Lender Responsibilities

Additional rulemaking is expected, at a minimum, to address recently authorized changes in forgiveness terms and corresponding modifications to the forgiveness application process, and to explain the SBA's Loan Review Procedures.

In addition to the rules, the SBA has issued three procedural notices for lenders:

1. [Guidance on Participation Sales for Paycheck Protection Program Loans](#)
2. [Guidance on Whole Loan Sales of Paycheck Protection Loans](#)
3. [PPP Lender Processing Fee Payment and 1502 Reporting Process](#)

The Treasury Department also released and has continued to update its [PPP Loans Frequently Asked Questions \(FAQs\)](#). The FAQs document indicates that while it does not carry the force and effect of law independent of the statute and regulations on which it is based, the "U.S. Government will not challenge lender actions that conform to this guidance." Other agencies, including the Federal Reserve, have also released guidance and interpretations relevant to the operation of the PPP.

Loan Terms

The SBA provided a [template application form](#) for the PPP and initially indicated that, unlike other SBA programs, applicants did not have to meet the "Credit Elsewhere" requirement, i.e., did not have to try to obtain some or all of the funds from other sources first. However, an update to the FAQs issued just prior to Congressional approval of the second tranche of funding (discussed above) contradicted that provision by requiring that borrowers certify that the funds are necessary and that no other source of funds is available.

The following loan terms are the same for all participants:

- Unsecured, no personal guaranty required.
- Fully guaranteed by the SBA and not subject to any SBA fees.
- Loans can be for up to two months of average monthly payroll costs (salaries up to a maximum of \$100,000 per employee, employee benefits including costs for employee vacation, parental, family, medical, and sick leave and state and local taxes assessed on compensation) from the last year, plus an additional 25% (subsequently changed as discussed below) of that amount for other specified costs such as small business mortgage and utility costs, up to a maximum of \$10 million. A borrower's payments to independent contractors or sole proprietors must be excluded from payroll costs; however, independent contractors and sole proprietors may be eligible

to apply for their own loan under the PPP. In a [document](#) issued on April 24, the SBA provided additional guidance on the calculation of payroll costs and required documentation for applicants that are:

- Self-employed with no employees.
 - Self-employed with employees.
 - Self-employed farmers who report income on Schedule F.
 - Partnerships.
 - Subchapter S and C corporations.
 - Nonprofit organizations.
 - Eligible nonprofit religious organizations, veterans' organizations and tribal businesses.
 - Limited liability company owners.
- Loans are made for two years at a 1%-fixed rate, with all payments deferred for six months, although interest will accrue during the period. The interest rate has been a point of contention throughout the PPP roll-out process. Although the CARES Act itself provides for a rate of up to 4%, the SBA initially set the program rate at 0.5%. After lenders raised concerns that this rate would, in many cases, fail even to meet their funding costs, the SBA increased the rate to its current 1%-level per the IFR.
 - Lenders must make the first disbursement of the loan no later than 10 calendar days after the loan is approved.
 - Loans are forgivable if the proceeds are used to cover eligible costs, and if the borrower retains its employee headcount and compensation levels; any remaining balance will have a maximum maturity per the CARES Act of 10 years from the date on which the borrower applies for loan forgiveness. However, and similar to the loan interest rate as discussed above, the regulation sets the repayment term for PPP loans at two years. (Subsequently revised, as discussed below.)

Applicants will need to provide evidence of their payroll costs and certify to their need for the loan, accuracy of the information provided, understanding of the terms of the loan and the forgiveness provision, and that they have not applied for another loan under this program. By regulation, small businesses may only receive one loan under the PPP in total.

Therefore, borrowers are encouraged to consider applying for the maximum eligible amount. A recent media report indicated, however, that many small businesses received loans two or more times due to a technical issue at the SBA, and suggested that total aid accidentally handed out could add up to hundreds of millions of dollars, which the government and lenders have been trying to recover.¹

Eligible Borrowers

Generally, small businesses with 500 or fewer employees are eligible to apply for a PPP loan. According to IFR2, if the applicant or the owner of the applicant is the debtor in a bankruptcy proceeding, either at the time it submits the application or at any time before the loan is disbursed, the applicant is ineligible to receive a PPP loan.

The FAQs clarify several points related to eligibility standards, including the following:

- For employee-based tests, borrowers may use either their average number of employees over defined time periods or the SBA’s usual calculation methodology in which size standards vary by industry, and are generally based on the number of employees or the amount of annual receipts the business has.
- In addition to qualifying for PPP loans under the 500-employee standard (or any alternative industry-specific/NAICS code employee standard established by the SBA), borrowers also qualify if they are “small business concerns” of a size normally eligible for SBA 7(a) loans. That means borrowers may qualify based on industry-specific revenue-based tests or the SBA’s “alternative size standard” for small business concerns, which requires that the maximum tangible net worth of the business is not more than \$15 million and the average net income after federal income taxes (excluding any carry-over losses) of the business for the two full fiscal years before the date of the application is not more than \$5 million.
- Employee-based tests are based on the number of employees whose “principal place of residence is the United States.”

The FAQs also address affiliation that exists when a company controls, is controlled by or is under common control with another company. It has been a particular concern among

¹ “U.S. small business program handed out virus aid to many borrowers twice,” Reuters, June 2, 2020: www.reuters.com/article/us-health-coronavirus-usa-ppp-exclusive/exclusive-us-small-business-program-handed-out-virus-aid-to-many-borrowers-twice-idUSKBN239159.

startups and other small businesses backed by minority investors that such affiliations could leave them ineligible to participate in the PPP.

- Under normal SBA 7(a) procedures, application of size standards requires that the borrower consider the aggregate size of the set of all companies affiliated with the applicant. For now, the SBA has indicated that the normal affiliation standards for SBA 7(a) loans apply to PPP loans, other than as expressly waived by the CARES Act and/or SBA guidance for the Accommodation and Food Services industries, certain franchise companies, companies receiving financial assistance from Small Business Investment Companies, and faith-based organizations. The FAQs confirm that it is the responsibility of the borrower to determine which entities (if any) are its affiliates and determine the employee headcount of the borrower and its affiliates. Lenders are permitted to rely on borrowers' certifications without needing to make an independent determination of the accuracy of this information.
- Minority owners, who normally may be viewed as still controlling a company through negative control rights (i.e., certain rights to prevent a quorum or otherwise block action by the board of directors or shareholders) may relinquish control for SBA affiliation purposes by irrevocably waiving or relinquishing such rights. Borrowers must certify to program eligibility (including affiliation-related issues by implication), but lenders do not have an independent obligation to verify the borrower's affiliation status.

The SBA also clarified that PPP lenders can make PPP loans to businesses owned by their directors and certain shareholders, subject to certain limits and without favoritism. On April 17, the Federal Reserve Board announced a [change](#) to its insider lending rules that will allow those individuals to apply for PPP loans, consistent with SBA's rules and restrictions. The change only applies to PPP loans.

Authorized Lenders

All federally insured depository institutions, federally insured credit unions and Farm Credit System institutions, as well as a broad range of nonbanks, are eligible to participate in this program. Existing SBA-certified lenders will have delegated authority. Others must apply and be approved by the SBA before making loans. Institutions that are subject to certain regulatory enforcement and/or safety and soundness concerns may not be eligible. The SBA has published a [list](#) of eligible lenders by state.

Loan Agreement and Related Terms

Lenders may use their own promissory note forms or an SBA form of promissory note, at their option, and any terms and conditions, including relating to amortization and disclosure, that are not inconsistent with Sections 1102 and 1106 of the CARES Act, the PPP IFR and guidance, and [SBA Form 2484](#). The SBA released its own form on April 7.

Lenders will not be allowed to charge any fees to applicants, but will receive processing fees from the SBA based on the balance of the financing outstanding at the time of the final disbursement, according to the following schedule:

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

Agents (e.g., lawyers, accountants, consultants and loan brokers) may assist applicants with the process and receive fees of 0.25% to 1.00%, depending on the size of the disbursed loan. Agent fees must be paid by the lenders, not charged to applicants. On April 2, the American Institute of Certified Public Accountants (AICPA) issued a statement on the role of CPAs as agents for PPP applications, indicating that based on the feedback it had received from many CPA firms, these firms were not planning to charge small business clients for assisting with their PPP applications, either because the CPA firms were committed to assisting their clients *pro bono* or because they believe the PPP application was simple and does not require their assistance. The AICPA statement went on to say that if a CPA firm is charging fees for advising a small business in deciding which loan program and tax relief program is best for its business, it is reasonable that those fees would fall outside the fee provision of the CARES Act and associated fees would be paid by the client. To date, the Treasury Department has not commented on this view.

Lenders will have to verify the dollar amount of average payroll costs and follow applicable Bank Secrecy Act requirements. Applicable regulations specifically refer to compliance with Customer Identification Program (CIP) requirements, and state the expectation that lenders will “understand the nature and purpose of their PPP customer relationships to develop customer risk profiles” from a BSA perspective, and file suspicious activity reports with FinCEN. The PPP FAQs have clarified that (1) a lender making a PPP loan to an existing customer is not required to re-verify borrower identification, unless otherwise indicated by the lender’s risk-based approach to BSA compliance, and (2) that federally insured depository institutions and federally insured credit unions eligible to participate in the PPP

program that have not yet collected beneficial ownership information on existing customers do not need to collect and verify beneficial ownership information, unless otherwise indicated by the lender's risk-based approach to BSA compliance. As more than one legal analysis of BSA-related requirements has noted, the PPP FAQs are not binding on enforcement of BSA requirements as a general matter; they only address whether a lender has met the SBA's PPP requirements. FinCEN's April 3 release, "[The Financial Crimes Enforcement Network Provides Further Information to Financial Institutions in Response to the Coronavirus Disease 2019 \(COVID-19\) Pandemic](#)," however, does confirm the guidance stated above. The release also indicates that FinCEN will continue to monitor developments and issue more guidance, as needed.

This interpretation by SBA and FinCEN favors existing customers and is contributing to the challenges that small businesses that do not currently have borrowing relationships with existing SBA lenders face in being able to apply for a PPP loan.

Applicable regulations further note that lenders that are not currently subject to BSA by statute must establish an AML program "equivalent to that of a comparable federally regulated institution." This requirement, which could represent a significant barrier to fintech firms that wish to join the program but are not currently subject to BSA requirements, is leading to ongoing discussions between the fintechs and established banks regarding potential partnerships that would, among other benefits, allow the fintechs to leverage the banks' existing BSA infrastructure.

Application Processing

The SBA has confirmed in its FAQ that a lender does not need a separate SBA Authorization for SBA to guarantee a PPP loan. However, lenders must have executed SBA Form 2484 to issue PPP loans and receive a loan number for each originated PPP loan.

The SBA released additional [guidance](#) on April 26 related to processing of applications for the second tranche of funding. This guidance allowed for one bulk submission per lender of XML files to E-Tran of a minimum of 15,000 loans. Submissions were to be processed individually and each loan in the bulk submission would be subject to funds available for the program and subject to the individual lender cap, which reportedly will be set at 10% of the total PPP funding authority (\$660 billion), exclusive of the \$60 billion set aside for lenders with assets under \$50 billion. Due to operational problems with the SBA's E-Tran system, on April 27 the bulk submission limit was reduced to 5,000 loans.

The SBA will not collect any fees for any guaranty sold into the secondary market. On May 1, the SBA issued its first guidance, a procedural notice, on secondary market sales. The notice covers obligations of purchasing and originating lenders, required documentation and required notice to, but not approval by, the SBA. On May 20, Citi announced a partnership program with the National Banking Association (NBA), through which Citi has created a purchasing facility that allows it to buy up to \$50 million in loans in the secondary market from Minority-Owned Depository Institutions (MDIs) originated under the PPP. This action is tied to Citibank's overall commitment to serve urban and underserved communities.

Previously, both the Federal Reserve and the Federal Home Loan Banks (FHLBanks) announced they will accept PPP loans as collateral for funding advances. On April 6, the Federal Reserve announced that it would open a facility to purchase SBA loans offered under PPP. This facility is described in a [term sheet](#) issued by the Federal Reserve on April 9. On April 23, the Federal Housing Finance Agency disclosed the [terms](#) under which the FHLBanks will accept PPP loans as collateral for FHLBank advances.

Loan Forgiveness

Lenders may be reimbursed for forgiven amounts in one of two ways:

- **Post-forgiveness:** After a lender makes a formal determination on a forgiveness application and processes the forgiveness payment, the SBA must pay the lender 100% of the forgiven amount within 90 days of the date of forgiveness (with interest from the date of forgiveness through the date of payment).
- **Pre-forgiveness:** 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 week seven of the covered period (that is, seven weeks after origination of the relevant PPP loans). The SBA must purchase these reported forgiveness amounts within 15 days of the report.

The CARES Act and SBA regulations state that a lender will not be subject to claims or penalties by the SBA for forgiving payments on a PPP loan if the lender bases the forgiveness determination on full documentation received by the lender from the borrower evidencing forgivable payments. Initial guidance indicated that a lender “does not need to conduct any 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 issued a [Loan Forgiveness Application](#) on May 15, but no governing regulations. The form, its accompanying worksheet and step-by-step instructions provide the following guidance and clarification related to the forgiveness calculation:

- To be eligible for forgiveness, payroll expenses do not have to be both “paid and incurred” in the exact eight-week period (Covered Period) that begins on the day that the first loan proceeds are received. Rather, a borrower may elect to use an Alternative Payroll Covered Period, which will begin on the first day of the borrower’s first pay period following the date that it receives its first PPP loan dollars, and will end on the 56th day thereafter. This assumes that all borrowers pay their employees in full and account for associated health insurance, retirement plan contributions, and state and local payroll taxes on the last day of each pay period.
- Interest, rent and “utilities” that are incurred during the original Covered Period and paid shortly thereafter in the normal course of business will also qualify to be forgiven.
- Confirmation of a new exemption from the loan forgiveness reduction for borrowers that have made a good-faith, written offer to rehire workers that was declined.

The instructions detail the supporting documentation that must be included with the Loan Forgiveness Application, as well as documentation that a borrower must maintain but is not required to submit. The application also includes several certifications and representations which the borrower is required to make. These deal with use of funds, as well as with the accuracy of calculations, and supporting documentation. To apply for forgiveness, a borrower must complete this application as directed and submit it to its lender.

One week after issuing the forgiveness application form and instructions, the SBA released two interim final rules: [Loan Forgiveness Requirements](#) and [Roles and Responsibilities of Borrowers and Lenders](#). The rules cover the process for loan forgiveness and supplement previous guidance and regulations related to loan forgiveness. They also include details on several technical questions related to employee status, payroll calculations and forgiveness-eligible nonpayroll expenses, some of which include new information and likely raise more questions on the part of lenders, particularly related to the still-limited guidance provided thus far about what specifically must be done to satisfy the “good faith review” of borrower documents that the lender is required to perform. The rules were effective upon issuance. The rules did not change the eligibility terms for forgiveness:

1. Nonpayroll costs (interest payments on business mortgage obligations, payments for business rent on real and personal property under lease, and business utility payments) are capped at 25% (subsequently changed as discussed below) of the total forgiveness amount.
2. Forgiveness is generally calculated for the eight-week period (subsequently changed as discussed below) from the disbursement of the PPP loan.
3. Certain reductions (subsequently changed as discussed below) will be made to a borrower's loan forgiveness amount based on reductions in full-time equivalent employees or in employee salary and wages during the covered period, subject to an important statutory exemption for borrowers who have rehired employees and restored salary and wage levels by June 30, 2020 (with limitations); there is a regulatory exemption to the reduction rules for borrowers who have offered to rehire employees or restore employee hours, even if the employees have not accepted.

At a high level, the general forgiveness process prior to the recent changes, which are discussed below, is as follows:

- The borrower completes and submits the Loan Forgiveness Application to the lender.
- Within 60 days, the lender reviews the application and makes a decision regarding forgiveness. Specifically, the lender must in good faith:
 - Confirm receipt of the borrower certifications contained in the Loan Forgiveness Application Form.
 - Confirm receipt of the documentation borrowers must submit to aid in verifying payroll and nonpayroll costs, as specified in the instructions to the Loan Forgiveness Application Form.
 - Confirm the borrower's calculations on the borrower's Loan Forgiveness Application, including the dollar amount of the Cash Compensation, Noncash Compensation, and Compensation to Owners claimed by performing a good faith review of the documentation submitted with the Loan Forgiveness Application.
 - With respect to the level of review required, the rule provides one example, stating that "minimal review" of payroll documentation furnished by a recognized third-party payroll processor might be reasonable, but gives no further guidance regarding what types of actions are expected for the "more extensive" review suggested for payroll information provided based on other sources. No guidance at

all is provided about the reviews that should be performed for other types of documents, such as those supporting how nonpayroll funds were spent.

- Confirm that the borrower made the Loan Forgiveness Calculation Form correctly, by dividing the borrower's Eligible Payroll Costs by 0.75.
- If the lender determines that the borrower is entitled to forgiveness of some or all of the amount applied for under the statute and applicable regulations, the lender must notify the borrower and request payment from the SBA at the time the lender issues its decision to the SBA.
- The SBA will, subject to its review of the loan and/or loan application, remit the appropriate forgiveness amount to the lender, plus any interest accrued through the date of payment, not later than 90 days after the lender issues its decision to the SBA.
 - If applicable, the SBA will deduct Economic Industry Disaster Loan (EIDL) Advance Amounts from the forgiveness amount remitted to the lender as required by the CARES Act.
 - If the SBA determines in the course of its review that the borrower was ineligible for the PPP loan based on the provisions of the CARES Act, the SBA rules or guidance available at the time of the borrower's loan application, or the terms of the borrower's PPP loan application (for example, because the borrower lacked an adequate basis for the certifications that it made in its PPP loan application), the loan will not be eligible for loan forgiveness.
- Any amount not subject to forgiveness will convert to a two-year term loan consistent with original PPP requirements.

Consistent with the prior announcement that the SBA will review all PPP loans over \$2 million, the IFR on loan forgiveness requirements notes that the general loan forgiveness process described above applies only to loan forgiveness applications that are not reviewed by the SBA prior to the lender's decision on the forgiveness application. It further states that in a separate IFR on SBA Loan Review Procedures and Related Borrower and Lender Responsibilities, the SBA will describe its procedures for reviewing PPP loan applications and loan forgiveness applications.

Finally, and in addition to the 90-day SBA review period described above, the rules also impose a six-year record retention period on borrowers and remind lenders of the existing

record retention requirements applicable to them under SBA regulations. Further, the IFRs establish a step-by-step process that lenders must follow in responding to SBA requests for information about PPP loans they have originated, and note that both the lender processing fee may be clawed back and loans considered ineligible for an SBA guarantee if the SBA determines the lender failed to meet its obligations under the IFR or the Lender Application Form. These provisions, coupled with the ambiguity described above regarding exactly what types of reviews lenders are expected to perform to meet their obligations, should be cause for concern among participating lenders and prompt them to ensure they have robust intake, review, documentation and record retention controls in place for all aspects of the forgiveness process.

Changes to PPP Forgiveness Terms

On Friday, June 5, the President signed into law the [Paycheck Protection Program Flexibility Act \(PPPFA\)](#). The PPPFA modified certain provisions of the PPP related to forgiveness and allows loan forgiveness recipients to defer their payroll taxes. Specifically, as it relates to forgiveness, the PPPFA:

- Extends the period in which borrowers have to spend the funds from eight weeks to 24 weeks after the origination of the loan (or December 31, 2020, whichever is earlier).
- Reduces the amount that needs to go to payroll costs to qualify for forgiveness from 75% to 60%.
- Introduces an exemption that allows for a reduction in eligible full-time employees if the borrower was unable to rehire the employees or similarly qualified employees, or is able to document the inability to return to the same level of business it was operating at before February 20, 2020, due to compliance with requirements established or guidance issued by the Secretary of Health and Human Services, the Director of the Centers for Disease Control and Prevention, or the Occupational Safety and Health Administration during the period beginning on March 20, 2020, and ending December 31, 2020, related to the maintenance of standards for sanitation, social distancing, or any other worker or customer safety requirement related to COVID-19.
- Extends the maximum maturity of loan balances not forgiven from two years to five years.

These changes may provide welcome relief to many small businesses that, because of government lockdowns, were forced to remain closed much longer than they may have initially anticipated and were unlikely to meet the original forgiveness criteria. They are also likely to result in some uptick in PPP applications from potential borrowers that did not find the original criteria realistic. For lenders, new terms are both good and bad: More loans are likely to meet the new forgiveness criteria, but original loans will stay on the balance sheet (barring secondary market sales) longer than anticipated.

Borrowers that received loans before June 5 can elect a forgiveness period of eight weeks (the original forgiveness period) and, if they meet the terms, would be advised to proceed with forgiveness applications as soon as they are eligible to eliminate ongoing compliance requirements. The SBA's forgiveness-related rules and the loan forgiveness form will need to be modified to reflect the PPPFA changes. Both lenders and borrowers have lingering concerns about the complexity and details of the forgiveness process. How real these concerns are will be tested as the process is operationalized.

Tax Implications

Expectations were that Congress intended that the PPP would come without a tax bill for the borrowers whose loans were forgiven. However, in a ruling on April 30, the IRS applied longstanding tax principles to the PPP that deny tax deductions for expenses associated with tax-exempt income. Specifically, the IRS announced that if a borrower receives forgiveness of a PPP loan, it will lose any tax deduction (up to the amount forgiven) for the payroll costs, mortgage interest, rent and utility expenses that are included in the forgiveness calculation. Given a 21%-tax rate means that the after-tax stimulus to the borrower would be \$0.79 and not \$1.00. Members of Congress have signaled their disagreement with this interpretation and an intent to reverse the IRS' call.

Audit and Investigations

The Treasury Department and the U.S. Department of Justice have both signaled plans to audit and investigate the PPP:

- On April 28, Treasury Secretary Mnuchin said the SBA plans to do a “full review” of PPP loans that are more than \$2 million before the loans are forgiven, and said that borrowers will face “criminal liability” if they falsely claimed that they needed the money to continue operations.
- Later in the week, on April 30, Assistant Attorney General Brian Benczkowski, the head of the Justice Department's criminal division, said in an interview that 15 to 20

of the largest loan processors and the SBA have been contacted as prosecutors look into how loans were issued under the PPP. He said the review has uncovered potentially problematic applications from companies that inflated their payroll costs or number of employees and misrepresented their business.

Other Considerations

To provide additional inducement to the banking industry to participate in the PPP, the CARES Act also:

- Mandates a zero percent risk weight of these loans for purposes of risk-based capital requirements.
- Provides temporary relief from FASB's troubled debt restructuring disclosure requirements to banks that modify the loans in a troubled debt restructuring related to COVID-19 on or after March 13, 2020.

On April 9, the federal banking agencies (Federal Reserve, Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation) announced an [interim final rule](#) to encourage lending to small businesses through PPP.

The interim final rule, which was effective immediately and subject to a 30-day comment period, modifies the agencies' capital rules to neutralize the regulatory capital effects of participating in the Federal Reserve's PPP facility because there is no credit or market risk in association with PPP loans pledged to the facility. Consistent with the agencies' current capital rules and the CARES Act requirements, the interim final rule also clarifies that a zero percent risk weight applies to loans covered by the PPP for capital purposes.

Next Steps

Protiviti has actively worked with our clients to operationalize their PPP participation and, where appropriate, explore technology solutions and alliances that have allowed them to respond in a timely manner. Based on this experience, some of the continuing challenges and priorities we expect to see in the coming weeks are:

1. Continued operational challenges through the completion of round two of the funding.
2. The need for lenders and qualified borrowers to move quickly to take advantage of the original eight-week forgiveness period and for lenders to plan for the extended forgiveness period.

3. Lenders and borrowers will need to prepare for audits and investigations of the information provided and used to support lender loan approvals.
4. Based on the assumption that the funding gap will soon close, small businesses will want to consider exploring other options, including state-level loan and grant programs that are being launched.

As states and cities begin to reopen nationwide, continued action is necessary to ensure small businesses, some of which have experienced an additional setback because of recent looting and vandalism conducted by bad actors taking advantage of the social unrest sweeping the country, will continue to play their critical role in the economy.

About Protiviti

Protiviti is a global consulting firm that delivers deep expertise, objective insights, a tailored approach and unparalleled collaboration to help leaders confidently face the future. Through its network of more than 85 offices in over 25 countries, Protiviti and its independent and locally owned Member Firms provide clients with consulting solutions in finance, technology, operations, data, analytics, governance, risk and internal audit.

Named to the [2020 Fortune 100 Best Companies to Work For®](#) list, Protiviti has served more than 60% of *Fortune* 1000® and 35% of *Fortune* Global 500® companies. The firm also works with smaller, growing companies, including those looking to go public, as well as with government agencies. Protiviti is a wholly owned subsidiary of Robert Half (NYSE: RHI). Founded in 1948, Robert Half is a member of the S&P 500 index.

Protiviti, along with other interested parties, participated in the #HackathonToSaveSmallBusiness, which was organized by the Alliance for Innovative Regulations (AIR), and continues to work with AIR and other hackathon participants to support the roll-out of the PPP.

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