On March 27, 2020, Congress passed, and President Trump signed, the Coronavirus Aid, Relief, and Economic Security Act (the CARES Act) in response to the COVID-19 emergency. Specifically, the CARES Act includes $349 billion to establish the new Paycheck Protection Program (the PPP) that expands the existing SBA Section 7(a) loan program until June 30, 2020 to provide 100% federally-backed loans to eligible businesses.

Subsequently, on April 3, 2020, the Small Business Administration (the SBA), in conjunction with the US Department of Treasury (the Treasury), adopted the PPP interim final rule (the Regulations) to implement the PPP and effectuate the expansion of the Section 7(a) loan program. The Regulations establish additional rules and requirements of the PPP, including a simplified application process for prospective PPP lenders and portfolio companies. Because the purpose of the CARES Act legislation is to provide immediate economic relief to small businesses, the Regulations became immediately effective without advance notice and a public comment period.

As of April 8, 2020, the SBA had already processed 381,000 PPP loans from more than 3,600 lenders totaling $100 billion. Congress is expected to commit at least another $250 billion to the PPP, as demand for PPP loans is high and banks are being flooded with applications faster than they can be processed. PPP loan applications are processed through the SBA’s E-Tran system, which experienced frequent crashes and other technical difficulties when the PPP launched on April 5, as its usual capacity is being increased by a factor of at least 50 times. However, on April 8, the SBA launched a new E-Tran gateway that provides more streamlined access to the E-Tran system, especially for new Section 7(a) lenders.

Banks have run into various challenges with the application process, including verification of borrower eligibility and appropriate PPP loan documentation. The Treasury and the SBA are frequently updating the FAQ guidance available here to answer questions from lenders and borrowers as they arise.

Who is eligible to provide a PPP loan, and how can a lender apply?

Existing Section 7(a) Lenders

Lenders currently authorized to extend loans under the Section 7(a) loan program are automatically authorized to approve and extend new PPP loans. The SBA’s list of the 100 most actively current eligible SBA 7(a) lenders can be found here and the database to search current SBA 7(a) lenders near your zip code can be found here.

Existing Section 7(a) lenders must submit SBA Form 2484 (Payroll Protection
Program Lender Application Form) and are automatically approved to make PPP loans.

Financial Institutions

The CARES Act authorized the Treasury and the SBA to designate additional lenders to extend PPP loans. In turn, the Regulations provide that the following financial institutions can become eligible Section 7(a) lenders under the PPP:

- Federally insured depository institutions;
- Federally insured credit unions; and
- Farm Credit System institutions.

The Regulations adopt a simplified lender application process for any of these three financial institutions. Federally insured depository institutions, federally insured credit unions and Farm Credit System institutions must submit SBA Form 3506 (CARES Act Section 1102 Lender Agreement) and will be automatically approved to make PPP loans (assuming they satisfy the eligibility criteria), unless they are designated in “troubled condition” by their federal regulator.

Non-Bank Lenders

The Regulations, in addition to establishing the above financial institutions as additional lenders, also established that certain non-bank lenders can become eligible to provide PPP loans. The non-bank lender must meet the following six qualifications to apply for eligibility to provide PPP loans:

- Be a depositary or non-depositary financing provider;
- Originate, maintain and service business loans or other commercial financial receivables or participation interests;
- Have a formal compliance program relating to auditing and compliance with applicable laws;
- Have a Bank Secrecy Act (the BSA) compliance program and operate in compliance with the BSA;
• Have been operating since at least February 15, 2019; and

• Have 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.\(^3\)

Eligible Section 7(a) non-bank lenders must submit SBA Form 3507 (CARES Act Section 1102 Lender Agreement) and email the completed application to NFRLApplicationForPPP@sba.gov.

With respect to the BSA, the Regulations require that non-depository institutions, such as fintech companies, Business Development Companies (BDCs) and small business investment companies (SBICs), apply the requirements under the BSA as federally regulated financial institutions. Although non-depository institutions are subject to certain applicable requirements of the BSA, they may not be able to comply with the BSA to the same extent as a bank. Non-depository institutions could choose to implement more comprehensive BSA compliance programs. However, this process could be time-consuming and costly to implement within the time period currently provided for the PPP, even though these non-depository institutions are already in a position to make loans to small businesses under their current regulatory regimes.

**Are financing options for PPP loans available?**

On April 9, 2020 the Federal Reserve issued a term sheet detailing that, in effort to support the SBA's PPP, the Federal Reserve is establishing the Paycheck Protection Program Liquidity Facility (the PPPLF) that will serve to extend credit to eligible Section 7(a) lenders originating PPP loans and will take those loans as collateral at face value. In essence, the PPPLF will provide liquidity to Section 7(a) lenders through term financing backed by PPP loans to eligible borrowers.

Currently, all banks that originate PPP Loans are eligible to borrow under the PPPLF, but the Federal Reserve is working on expanding eligibility to additional lenders that originate PPP loans. The maturity date of an extension of credit under the PPPLF will equal the maturity date of the PPP loan pledged to secure the extension of credit. Extensions of credit under the PPPLF will be made at a rate of 35 basis points, and there will be no fees associated with the PPPLF.

In addition, to help banks make use of the new facility, the federal banking agencies have issued an interim final rule that will allow banks to neutralize the regulatory capital effects— with respect to leverage and risk-based ratios— of loans pledged to the PPPLF.

Extensions of credit under the PPPLF will be available until September 30, 2020.

**Who is eligible to receive a PPP loan and how can a portfolio company apply?**
Under the SBA size standards, and subject to the SBA affiliation rules described below, many BDC and SBIC portfolio companies may be eligible to apply for PPP loans to help pay operational costs such as payroll, rent, group health benefits, insurance premiums and utilities. Eligible portfolio companies that may receive PPP loans include any business concern, nonprofit organization, veteran’s organization, or Tribal business that has no more than 500 employees (or employs the standard number of employees established by the SBA for the industry in which the entity operates). The SBA’s size standards make reference to the North American Industrial Classification System (NAICS) codes and are based on either the number of employees or receipts, depending on the industry, and can be found here.

In addition to the eligibility requirements discussed above, the Regulations established certain “ineligibility” requirements. For example, the Regulations exclude household employers (i.e., individuals who employ household employees) and companies engaged in activities illegal under federal, state or local laws. The Regulations also exclude companies who have a 20% or more equity owner that is incarcerated, on probation or parole. Notably, this exclusion might require applicants to receive certain certifications from 20% or more equity owners to ensure the applicant meets the PPP eligibility criteria.

To apply for a PPP loan, a portfolio company must submit SBA Form 2483. The application requires the portfolio company to make certain good faith certifications regarding its PPP loan eligibility, including that it will provide the lender with documentation verifying the number of full-time equivalent employees on the payroll.

Do the SBA affiliation rules apply to PPP portfolio companies?

In determining how many employees it is deemed to have for SBA purposes, a portfolio company applying for a PPP loan should consider the SBA affiliation rules applicable to PPP loan applicants (the PPP Affiliation Rules), which replace the traditional SBA affiliation rules for this purpose. Under both the PPP Affiliation Rules and the traditional SBA affiliation rules, entities are required to aggregate the employees of their affiliates in their employee count determination.

For SBA purposes, entities are “affiliates” when one controls or has the power to control the other, or a third-party or parties controls or has the power to control both. The PPP Affiliation Rules establish four scenarios that the SBA determined would establish “affiliation” for purposes of the PPP size standards:

- **Affiliation based on ownership:** Affiliation is established by ownership or power to control 50% of a portfolio company’s voting equity or the ability to prevent a quorum or otherwise block action of the board of directors or stockholders. The SBA will deem a minority shareholder to be in control, if that individual or entity has the ability, under the portfolio company’s charter, bylaws or shareholder’s agreement, to prevent a quorum or
otherwise block or “veto” certain actions by the portfolio company’s board of directors or shareholders. Additional SBA guidance on this point is available at this link.

• **Affiliation arising under stock options, convertible securities and agreements to merge:** The SBA will consider stock options, convertible securities and agreements to merge as though the rights granted have been exercised. Some exceptions apply, such as agreements to open or continue negotiations towards a possible merger or sale of stock, or the options, convertible securities or agreements are speculative or the probability of the transaction is remote.

• **Affiliation based on management:** An affiliation arises if the CEO or President of a company (or other top management) controls the management of another entity. Affiliation also arises when the same individual or company controls the board of directors of two or more companies. Finally, an affiliation arises if an individual or company controls the management of another company through a management agreement.

• **Affiliation based on identity of interest:** Affiliation arises when two entities have an “identity of interest.” In other words, the SBA may determine that the interests of two entities should be aggregated because the entities are so closely related (e.g., operate in the same industry and the same geographical area and, an officer or director of one company owns at least 20% of the equity of the other company).

Under the PPP Affiliation Rules, the affiliate aggregation rules are specifically waived for:

- businesses in the accommodation and food services sector;
- franchises; and
- any business that receives financial assistance from an SBIC.

The PPP Affiliation Rules in the SBA’s “small business” size test may still require a portfolio company’s size to be considered together with all other portfolio companies of its major investors (including, for private equity and venture capital funds, portfolio companies of earlier or later funds with common management). For instance, if a private equity fund is deemed to control the portfolio company, then the employees of every other portfolio company that the private equity fund controls will be included in the private equity fund’s total number of employees, unless any of the three affiliation rule waivers described above apply. This may make PPP loan eligibility difficult for such portfolio companies.

Portfolio companies that are not eligible for a PPP loan as a result of the PPP Affiliation Rules may want to consider similar programs or facilities being established by the Federal Reserve to enable additional lending options to small
and mid-sized businesses having between 500 and 10,000 employees. More information can be found here.

How can a portfolio company use a PPP loan?

A portfolio company can use a PPP loan to cover:

- payroll costs;
- costs related to the continuation of group health care benefits;
- employee salaries, commissions or similar compensations;
- payments of interest on any mortgage obligation;
- rent and utility payments;
- interest on any other debt obligations that were incurred before February 15, 2020; and

Further, the Regulations now require that at least 75% of the PPP loan proceeds be used for payroll costs. The SBA and Treasury indicated that the 75% threshold was appropriate to ensure that loans are directed to effectuate the CARES Act’s overarching purpose of payroll protection for employees.

What are the fees associated with PPP loans?

Fees Payable to PPP Lenders

The SBA will pay lenders fees for processing PPP loans in the following amounts:

- 5% for loans up to $350,000
- 3% for loans between $300,000 and $2,000,000
- 1% for loans of at least $2,000,000

Fees Payable to PPP Agents

If an agent assists a PPP borrower in completing the PPP application, any applicable agent fees will be paid by the PPP lender out of these fees that the lender receives from the SBA. The total amount that an agent may collect from
the lender may not exceed:

- 1% for loans up to $350,000
- 0.5% for loans between $300,000 and $2,000,000
- 0.25% for loans of at least $2,000,000

**Fees Payable by PPP Borrowers**

Borrowers will not owe any upfront or ongoing fees on a PPP loan.

**What are the terms and conditions of a PPP loan?**

*Maximum Amount:* Generally, PPP loans are capped at two and a half times the average monthly payroll costs of the portfolio company, and in no event can a PPP loan exceed $10 million. Notably, recent Treasury Department guidance indicates that non-cash benefits, including items such as employer contributions to retirement plans and employer payments for group health care coverage, are generally not included in the calculation of monthly payroll costs.

*Portfolio Company Certification:* Eligible portfolio companies are required to make a good faith certification to the PPP lender that the portfolio company (i) requires the funds to operate due to the current COVID-19 economic disruptions, and (ii) will use the funds for eligible PPP uses (discussed above). The Regulations also provide more detail on the certifications the PPP borrower application requires (e.g., applicant has yet to and will not receive a subsequent loan under the PPP).

*Interest Rates:* Under the CARES Act, the interest rate on a PPP loan cannot exceed four percent, but the Regulations set the interest rate on a PPP loan at one percent. The Regulations provide for a six-month deferment on interest, but interest will continue to accrue on the PPP loan during the six-month deferment.

*Maturity Date:* The CARES Act provides for maximum maturity of up to ten years from the date the borrower applies for loan forgiveness, but the Regulations limit the maturity to two years. In the Regulations, the SBA and Treasury expressed their view that a two-year maturity was appropriate because the economic disruption caused by the coronavirus is expected to abate well before the two-year maturity date.

*Credit Elsewhere:* Eligible portfolio companies will not be required to demonstrate that they are unable to obtain credit elsewhere.

*Collateral:* There will be no collateral requirements for PPP loans.

*Personal Guarantee:* There will be no personal guarantee requirement for PPP
loans.

Lender Underwriting Obligations: The Regulations provide detail about the specific underwriting obligations of lenders under the PPP (e.g., confirm receipt of borrower certifications and borrower payroll documentation, follow the requirements of the BSA).

What are the qualification requirements for a PPP loan?

A PPP lender is required to consider the following before determining whether a borrower is eligible to receive a Section 7(a) loan:

• That the borrower was in operation on February 15, 2020; and

• That the borrower (i) had employees for which it paid salaries and payroll taxes, or (ii) paid independent contractors reported on tax Form 1099-MISC.

Are PPP loans eligible for forgiveness?

A portfolio company can apply for PPP loan forgiveness if it demonstrates that the loan proceeds were used for the eligible purposes discussed above during an eight-week period following the loan. Indebtedness will be forgiven (and excluded from gross income) in an amount equal to the costs incurred and payments made for eligible purposes (e.g., payroll/benefits (excluding employee compensation above $100K), mortgage interest, rent and utilities) during the covered period (eight-weeks beginning on the date the lender originates the PPP loan for the portfolio company). Forgiveness amounts are limited to the principal amount borrowed. Additionally, the Regulations limit the non-payroll portion of the forgivable loan amount (e.g., mortgage interest, rent, utilities) to 25% of the forgivable amount.

However, if the portfolio company reduces salaries or cuts employees, the forgiveness amount will be correspondingly reduced. If the portfolio company rehires the employees or ends the salary reduction before June 30, 2020, the loan amount eligible for forgiveness will not be affected.

A portfolio company seeking loan forgiveness with respect to a PPP loan is required to submit to the lender that is servicing the loan an application that provides certain documents and makes certain certifications. The lender is entitled to then rely on the borrower’s documentation for loan forgiveness and is not required to conduct any additional verification.

In the Regulations, the SBA noted that it intends to issue additional guidance on loan forgiveness.

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1 The full text of the CARES Act is available at this link and the full text of the Regulations is available at this link.
3 Non-bank lenders that (i) are a service provider to an insured depository institution, and (ii) have a contract to support such institution’s lending activities in accordance with 12 U.S.C. § 1867(c) are also eligible Section 7(a) lenders.

We will continue to post updates on the CARES Act and other topics related to COVID-19 via our BDCESSENTIALS mobile app, available through the Apple App Store, Google Play and the Amazon App Store. Additionally, we have created an online hub to centralize our legal briefings to clients around the world. The hub will be updated on a regular basis as we issue further briefings on topics related to COVID-19 and can be accessed by clicking the link below: https://www.eversheds-sutherland.com/global/en/what/publications/coronavirus.page