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**Huddle: PPP Edition C/A Top 10 FAQs April 8, 2020**

**Q1. Does Regulation O apply to PPP and bank insider?**

**A1:** The CARES Act nor the implementing regulations directly prohibit bank insiders from participating in the Paycheck Protection Program—however, one of the requirements of the PPP is compliance with the SBA's 120.110 and SOP 50 10 which defines eligibility, which contains and cross references some fairly broad restrictions. That is not to say, assuming the insider is not ineligible, that they cannot apply for PPP loan at another institution. But the Interim Final Rule for the PPP cross references existing SBA restrictions for 7(a) loans—associates of lenders cannot be essentially any kind of owner of the applicant business. This includes officers, directors, key employees or any owners—so it essentially cuts out all insiders (with only an extremely narrow circumstance for Reg O insider to not fall under SBA restrictions). Compliance Alliance is advising banks to comply with all Regulation O requirements as there is no specific exemption, as well as to establish a reciprocal program at another financial institution for PPP loans of your bank’s insiders.

See generally:

*c. How do I determine if I am ineligible?
Businesses that are not eligible for PPP loans are identified in 13 CFR 120.110 and described further in SBA’s Standard Operating Procedure (SOP) 50 10, Subpart B, Chapter 2, except that nonprofit organizations authorized under the Act are eligible. (SOP 50 10 can be found at https://www.sba.gov/document/sop50-10-5-lender-development-company-loan-programs.)*
<https://home.treasury.gov/system/files/136/PPP--IFRN%20FINAL.pdf>

*III. INELIGIBLE TYPES OF BUSINESSES A. The Lender must determine whether the Applicant is one of the types of businesses listed as ineligible in SBA regulations (13 CFR § 120.110). Certain business types appearing on this list may be eligible under limited circumstances, as discussed below.*
*14. Equity Interest by Lender or Associates in Applicant Concern (13 CFR § 120.110(o))*
*a) A Lender or any of its Associates, may not obtain an equity interest, either directly or indirectly, in the Applicant.*
*b) The only exception is when the Associate of the Applicant is a Small Business Investment Company (SBIC), in which case the requirements of 13 CFR § 120.104 apply. See also 13 CFR § 120.140 for a list of ethical requirements that apply to Lenders.*
<https://www.sba.gov/sites/default/files/2017-10/SOP%2050%2010%205%28J%29_FINAL_.pdf>

*"§120.110   What businesses are ineligible for SBA business loans?*
*The following types of businesses are ineligible:*

*...*
*(o) Businesses in which the Lender or CDC, or any of its Associates owns an equity interest;"*
<https://www.ecfr.gov/cgi-bin/text-idx?SID=40c56d244eaa72026eaf7b8c125bb7ec&mc=true&node=pt13.1.120&rgn=div5#se13.1.120_1110>

*Associate. (1) An Associate of a Lender or CDC is:*
*(i) An officer, director, key employee, or holder of 20 percent or more of the value of the Lender's or CDC's stock or debt instruments, or an Agent (as defined in §103.1 of this chapter) involved in the loan process; or*
*(ii) Any entity in which one or more individuals referred to in paragraphs (1)(i) of this definition or a Close Relative of any such individual owns or controls at least 20 percent.*
<https://www.ecfr.gov/cgi-bin/text-idx?SID=40c56d244eaa72026eaf7b8c125bb7ec&mc=true&node=pt13.1.120&rgn=div5#se13.1.120_1110>

**Q2. Can employers include wages paid to H1-B Visa workers in their payroll calculations? What about seasonal, legal immigrant workers?**

**A2:** While H1-B Visa workers and legal immigrant workers are not expressly excluded from the Paycheck Protection Program in and of themselves, one of the conditions for "payroll costs" is that "any compensation of an employee whose principal place of residence is outside" of the US has to be excluded, unfortunately.

“(viii) the term ‘payroll costs’—
…
“(II) shall not include—
…
“(cc) any compensation of an employee whose principal place of residence is outside of the United States;
<https://www.congress.gov/bill/116th-congress/house-bill/748/text#HE4E7B1F84B384B0D92459C0BEB5AA857>

 **Q3. Do you have any guidance on how to qualify a self-employed person based upon net earnings?**

**A3:** The SBA April 7th FAQ addresses calculating qualifying payroll expenses for purposes of maximum loan amount, allowable uses of a PPP loan and the amount of loan forgiveness in their FAQ 15 and 16.

*#15 states that any amounts that an eligible borrower has paid to an independent contractor or sole proprietor should be excluded from the eligible business’s payroll costs. However, an independent contractor or sole proprietor will itself be eligible for a loan under the PPP, if it satisfies the applicable requirements.*

*#16 states that, under the Act, payroll costs are calculated on a gross basis without regard to (i.e., not including subtractions or additions based on) federal taxes imposed or withheld, such as the employee’s and employer’s share of Federal Insurance Contributions Act (FICA) and income taxes required to be withheld from employees. As a result, payroll costs are not reduced by taxes imposed on an employee and required to be withheld by the employer, but payroll costs do not include the employer’s share of payroll tax. For example, an employee who earned $4,000 per month in gross wages, from which $500 in federal taxes was withheld, would count as $4,000 in payroll costs. The employee would receive $3,500, and $500 would be paid to the federal government. However, the employer-side federal payroll taxes imposed on the $4,000 in wages are excluded from payroll costs under the statute.2*

*2The definition of “payroll costs” in the CARES Act, 15 U.S.C. 636(a)(36)(A)(viii), excludes “taxes imposed or withheld under chapters 21, 22, or 24 of the Internal Revenue Code of 1986 during the covered period,” defined as February 15, 2020, to June 30, 2020. As described above, the SBA interprets this statutory exclusion to mean that payroll costs are calculated on a gross basis, without subtracting federal taxes that are imposed on the employee or withheld from employee wages. Unlike employer-side payroll taxes, such employee-side taxes are ordinarily expressed as a reduction in employee take-home pay; their exclusion from the definition of payroll costs means payroll costs should not be reduced based on taxes imposed on the employee or withheld from employee wages. This interpretation is consistent with the text of the statute and advances the legislative purpose of ensuring workers remain paid and employed. Further, because the reference period for determining a borrower’s maximum loan amount will largely or entirely precede the period from February 15, 2020, to June 30, 2020, and the period during which borrowers will be subject to the restrictions on allowable uses of the loans may extend beyond that period, for purposes of the determination of allowable uses of loans and the amount of loan forgiveness, this statutory exclusion will apply with respect to such taxes imposed or withheld at any time, not only during such period.*

*Resource:* [*https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequenty-Asked-Questions.pdf*](https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequenty-Asked-Questions.pdf)

**Q4. Are small business customer's that have 1099 employees eligible?  The Interim Final rule appears contradicts itself.**

**A4:** No, you are not missing this apparent contradiction. The regulation appears to contradict itself which causes a lot of confusions. But there is a breakdown:

For purposes of determining whether you are a small business, you needed to have met the following requirements:

1. 500 or fewer employees
2. Whose principal place of residence is in the United States
3. Operating on February 15, 2020 and had:
	1. Employees for whom you paid salaries or payroll taxes; OR
	2. Paid independent contractors as reported on Form 1099-MISC.

That is ***only*** applicable just to determine if the business meets the eligibility criteria for a small business to receive a PPP loan.

When it comes time for the small business to calculate its maximum loan amount, the final rule takes away independent contractors –the intent of the rule is to have them apply by themselves.

So, in short—it is a contradiction but they iron it out with what it applies to:

1. Independent contractors count when a business is determining whether it’s a small business

BUT they do not count when:

1. The small business is determining their maximum loan amount calculations. The intent of the Rule is for IC’s to apply separately.

**5. Is beneficial ownership required on PPP Loans?**

A5: Although FinCEN came out with guidance on April 3rd, and the SBA issued an FAQ late last night, it still is a point of confusion for banks. They stated that for eligible federally insured depository institutions and federally insured credit unions, 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. The SBA’s recent FAQ does ask specifically about collecting, certifying AND verifying beneficial ownership information about existing customers.

The guidance from both FinCEN and SBA do not mention recertification as being exempt, which, in a strict reading, means that recertifying your verification documents still is applicable with PPP borrowers who are current customers. It remains technically ambiguous.

**Q6: Is it a hardline rule or a best practice to not require a deposit account or control account?**

**A6:** Many financial institutions are trying to determine whether there are any conditions upon which to collateralize these PPP loans, albeit indirectly, with the intent to protect the bank’s capital and liquidity. Conservatively, a strict reading interpretation of the Interim Final Rule would seem that financial institutions cannot be requiring PPP borrowers to open deposit accounts with their institutions for purposes of accessing the funds and additionally, those funds need to be provided outright and cannot be held like a draw line of credit. Participation in this Program and subsequent forgiveness requires certification that the “Lender has complied with the applicable lender obligations set forth in…the Paycheck Protection Program Rule.”

The guaranty and collateral prohibitions are very explicit that no personal guarantee shall be required for the covered loan; and no collateral shall be required.

However, the question remains of how financial institutions are to protect their interests when participating in this Program. Requiring a deposit account, a draw type scenario or a savings account with a controlled disbursement runs a risk of being interpreted as circumventing the Interim Final Rule, both by requiring additional fees in connection with the PPP loan (i.e.-any fees charged on a deposit account) and requiring access to an asset that the bank could set-off in the event of default.

Yet, the other position is that banks should be afforded the right to open a separate account or a control account to assure Program compliance with the guaranty. The control account would need to require no fees, and there is the argument on whether or not the right of offset in the event of default would even be permissible or not. Using the loan proceeds as collateral is still a form of collateral—but financial institutions are being left with little recourse if the borrower uses the PPP funds for an unauthorized purpose.

An additional issue is, if the borrower defaults or there is a remaining balance that is not used towards the PPP loan purpose (which would not be forgiven), there is the potential for banks to apply those funds towards the outstanding balance, thus lowering the amount the borrower would owe the bank on any amount not forgiven by the SBA. If the borrower knowingly misuses the funds, the penalty is on the borrower, but not without ramifications to the financial institution who is left holding the debt.

So, while there is no indication within the Interim Final Rule that the bank is required to monitor for misuse, it is an argument that it is a risk too great for financial institutions not to monitor. With either interpretation, financial institutions remain at risk of being in violation of the Interim Final Rule by requiring a controlled account, yet they are not required to monitor the use of the funds to begin with.

An additional question unaddressed in the Interim Final Rule is whether this Program is subject to the normal guaranty process for the SBA, meaning would the bank have to ensure compliance with the guarantee guidelines? Generally, financial institutions need to ensure that the borrower follows the guarantee requirements, whereby for calculation purposes for legal lending limits, the bank would receive a higher percentage for guaranteed amounts. Financial institutions run the risk of immediately or potentially being in non-compliance with their lending limits, depending on the amount of outstanding loans to that borrower.

In conclusion, there are two schools of thought:

1. Conservatively, provide to the borrower the entire balance into their account or provide them a check; or
2. In the interest of bank protections, open a control account with zero fees knowing that all monies must be disbursed and cannot be used to pay down any remaining principal.

The latter is not expressly addressed and remains an interpretation and may run the risk of being found to circumvent the Program requirements, negating loan forgiveness. Financial institutions will need to ensure, regardless of the method used, that its policies and procedures document frequency of monitoring accounts, ensure no fees are applicable to these accounts, and have procedures for when funds are used for unauthorized purposes. These procedures would need to be consistently applied among all PPP borrowers for fair lending considerations. And due to the nature of the COVID-19 environment, with the increased use of remote employees, having these policies and procedures in writing and consistent is going to be paramount.

**Q7: Do the loan documents have to be dated the same date as the SBA approval for SBA in order to fund? What if the loan documents are dated April 3, but SBA approval isn't dated until April 4: Will there be a chance that SBA wouldn't fund the loans?**

**A7:** There unfortunately is no certainty with this aspect of the Program, which is one of the biggest concerns of its swift implementation.  There is a lack of guidance, a lack of loan documentation resources (i.e.-standardized note), and well as basic calculation concerns.  This accounts for the reasoning of why many organizations have chosen not to participate in this Program, or, at a minimum, have capped the bank’s credit risk and lending capital to a specific threshold (i.e.- maxed at $10 million) or limited their approved applicant based to current customers, or borrowers with smaller employee thresholds (i.e.- 50 employees max rather than 500). Some forms providers (LaserPro) have already developed a standardized note for their customers.  Other are having legal counsel draw them up, but the fact remains, there is little to no guarantee within the parameters of the Program that what is specifically being required by the SBA is being met by banks’ implementing of the Interim Final Rule at face value.

What this boils down is the bank’s assumption risks and what they are willing to wager. While there is no indication that the bank cannot fund prior to SBA approval and not receive the guaranty, or that the guaranty form has to be done on the same day as the note date, there are risks of this being a violation or risks that the SBA does not approve the loan that you have already funded. SBA is within their power to come back stating that the required information was not obtained or the loan was otherwise done in violation of any other requirements in the rule. Whether or not the bank chooses to wait or fund, the risks associated with it should be brought to your board of directors or some other governing committee for a determination of risk.

Now there has been some communications between banks and the SBA where the SBA is telling financial institutions to wait to fund until the bank receives confirmation from the SBA. Others may not be receiving this information or may not be waiting.

**Q8: Are banks free to rely on borrower attestations on eligibility of business, like with affiliation?**

**A8:** It’s kind of a Catch-22 scenario with the bank left holding the smoking gun.  The borrower has to certify with attestations that they are a small business that is eligible, that they meet the PPP requirements and can show documentation that’s verified and accurate for payroll costs in order for the loan to meet the PPP standards and receive the 100% guaranty by SBA. The bank is merely processing and, unfortunately, funding these applications at 1% unsecured. The SBA says that they will “hold harmless” any lender that relies on such borrower documents and attestations but that *does not* mean they will apply the guaranty (at face value). That means they will not *prosecute* the bank in funding a loan that assisted a borrower in taking advantage of the PPP’s funds.  There has been no guidance that if the bank incorrectly funded a non-eligible business that the bank is off the hook on the loan and the guaranty applies. The bank is still left holding a 1% unsecured loan with a borrower who now faces potential criminal charges from the government; or in a less dramatic situation, a borrower who unknowingly did not qualify (due to the confusing nature of eligible small businesses, payroll costs calculations, etc.) and now is stuck with the loan and the bank an unsecured one at that.  Either scenario, however, it does not change the fact the bank is left with the loan and no guaranty.

This is just extremely ambiguous on where bank has to do additional due diligence and what they have to rely on. The way the FAQs and Interim Final Rule are written make it appear banks do not have to do anything except take an application, verify payroll and fund.

**Q9: How do lenders get paid their processing fee from the SBA?**

**A9:** In regards to processing fee payment from SBA to lenders, the Interim Final Rules states that the SBA will pay lenders their approved percentage within five days after funding based on the funded amount, but unfortunately again, the Interim Final Rule is not clear whether the bank has to notify SBA upon funding, whether submission of documents to SBA puts them on notice, or if SBA will reach out to determine what funded. There is just zero guidance as to how lenders need to get paid. Waiting for SBA guidance or attempting to contact SBA is the only option at this time.

There is just no definition on funding from the SBA to determine timeline—they only state in the Interim Final Rule “5 days after disbursement of the covered loan”—which could mean when bank funds are disbursed but not necessarily. SBA needs to define disbursement date.

**Q10: How are PPP loans to be treated on the Call Report? Do PPP loans count towards CRA?**

**A10:** There has not yet been any guidance up to this point that would indicate treating these differently from any other similarly situated loan, or any guidance about special call report reporting requirements for PPP loans. These would be reported under Commercial and Industrial Loans as they are unsecured and also guaranteed by the SBA.
RC-C-13: <https://www.fdic.gov/regulations/resources/call/crinst-051/2018-06/051-618rc-c1-063018.pdf>

In most cases, yes. According to existing examination guidance as well as the March 19, 2020 [Joint Statement on CRA Consideration for Activities in Response to the COVID-19](https://www.fdic.gov/news/news/financial/2020/fil20019a.pdf), when consistent with safe and sound banking practices and applicable law, loans that benefit small businesses and small farms impacted by COVID-19 serve the long-term interest of those communities and the financial system. Generally, loans to for-profit businesses in amounts of $1 million or less are considered small business loans in CRA evaluations and will be considered as such under the lending test. Additionally, PPP loans to small businesses could receive consideration as innovative or flexible lending practices. Generally, loans to businesses greater than $1 million to small businesses that create or retain jobs would qualify as community development loans under economic development if the loans create or retain jobs or under revitalization/stabilization if they benefit primarily low- and moderate-income areas or distressed middle-income areas. Resource: <https://www.fdic.gov/coronavirus/smallbusiness/faq-sb.pdf>

Safety and soundness are going to be key with the PPP.

“The Federal Reserve Board on Wednesday announced that it will temporarily and narrowly modify the growth restriction on Wells Fargo...The growth restriction does not prevent the firm from engaging in any type of activity, including the PPP" <https://www.federalreserve.gov/newsevents/pressreleases/enforcement20200408a.htm>

Understanding your credit risks, capital liquidity, ensuring strong ledgers and knowing the risks of participating in this program to your institutions is paramount.