

# Client Alert

May 2020

## Memorial Day Weekend 2020: Two New Rules on Paycheck Protection Program Loan Forgiveness Process

Late on Friday, May 22<sup>nd</sup>, the Small Business Administration (“SBA”) released two interim final rules (“IFRs”) addressing the forgiveness process of the Paycheck Protection Program (“Triple P” or “PPP”).<sup>1</sup> The first IFR supplements previous regulations and guidance on the discrete issues related to loan forgiveness and the second IFR informs borrowers and lenders of the SBA’s process for reviewing loan applications and loan forgiveness applications, as well as the responsibilities of borrowers and lenders (the two IFRs are collectively referred to as the “Forgiveness Rules”). The Forgiveness Rules raise a number of important issues for both borrowers and lenders, this client alert summarizes some of the major items that are particularly concerning.

We reviewed these Forgiveness Rules keeping in mind congressional efforts to make certain significant changes to the Triple P.<sup>2</sup> As Congress shifts its focus from employment to small business survival, the primary changes that are being considered involve extending the forgiveness period, revising restrictions on non-payroll expenses, extending loan terms, and establishing additional safe harbors for businesses that are unable to rehire employees by the required deadline. While the proposed changes are welcome, Congress has not yet addressed the need to simplify the forgiveness process for borrowers and to alleviate the significant logistical and operational burden on Triple P lenders.<sup>3</sup> Absent such congressional intervention, borrowers and lenders alike are left with the 30+ pages of Forgiveness Rules added Friday on top of the 11 page forgiveness application form with supporting schedules.

### IFR on Loan Forgiveness

Friday’s first IFR focuses specifically on the loan forgiveness requirements. The SBA states that “[b]y providing a high degree of certainty to PPP borrowers through this interim final rule, PPP borrowers will be able to take immediate steps to maximize their forgiveness amounts....” The use of the word *immediately* is peculiar considering the guidance comes when many borrowers are nearing the exhaustion of their Triple P loan proceeds.

This IFR starts with a definition of “payroll costs” and “non-payroll costs” by incorporating the specific language of the CARES Act and prior interim final rules.<sup>4</sup> These definitions remain the same and not much insight is provided on the still unclear eligible utility payments, such as what type of “service

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<sup>1</sup> [Interim Final Rule on Loan Forgiveness](#), May 22, 2020; [Interim Final Rule on SBA Loan Review Procedures and Related Borrower and Lender Responsibilities](#), May 22, 2020.

<sup>2</sup> Such efforts include the Heroes Act ([H.R. 6800](#)), recently passed by the U.S. House of Representatives, as well as the proposed Paycheck Protection Program Flexibility Act ([H.R. 6886](#)) expected to be voted on this week, or the [Paycheck Protection Program Extension Act](#) proposed by Senator Collins.

<sup>3</sup> Almost 75% of Triple P borrowers have indicated that the terms and conditions of the Triple P are somewhat or very difficult to comprehend based on a National Federation of Independent Business (NFIB) survey. The survey was conducted before Friday’s IFRs.

<sup>4</sup> 15 U.S.C. 636(a)(36)(A)(viii); 85 FR 20811, 20813.

agreement” is required to support certain transportation expenses. The SBA also reiterates the requirement that non-payroll costs cannot exceed twenty five percent of the loan forgiveness amount.

## The Loan Forgiveness Process

Borrowers must complete and submit the SBA Form 3508 Loan Forgiveness Application (or a lender equivalent, each referred to as the “Forgiveness Application”) to receive loan forgiveness. Lenders must review the application and make the initial decision regarding loan forgiveness within 60 days from receipt of a *complete* application. If the lender determines that the borrower is entitled to forgiveness for some or all of the amount requested, the lender must submit a request for payment from the SBA at the time the lender issues its decision. As implied in this IFR, and explicitly stated in the second IFR, lenders are responsible for determining whether borrowers are not eligible for some or any of the requested forgiveness amount. The IFR also states that “[t]he general loan forgiveness process...applies only to loan forgiveness applications that are not [specifically] reviewed by the SBA prior to the lender’s decision on the forgiveness application.” Additional more substantial details regarding the loan forgiveness process are outlined in the second IFR, as described below.

## Payroll Costs Eligible for Loan Forgiveness

The IFR ratifies much of what was released in the Forgiveness Application, including clarifying that payroll costs paid or incurred during the eight consecutive week covered period are eligible for forgiveness. Payroll costs are considered paid either on the day that paychecks are disbursed or when the borrower originates an ACH credit transaction. Incurred payroll costs must be paid on or before the next regular payroll date after the end of the covered period. The eight-week period is either the period starting on the date the loan was disbursed or the “alternative payroll covered period” as previously defined in the Forgiveness Application and now formally adopted.<sup>5</sup>

In what should come as some relief to borrowers, the IFR clarifies that the SBA will follow the CARES Act in broadly defining the term “payroll costs” provided that an employee’s total compensation does not exceed \$100,000 on an annualized basis. Accordingly, borrowers will now be able to count short term hazard pay and bonuses for forgiveness.

Owner-employees and self-employed individuals are subject to a cap on the amount of loan forgiveness equal to the *lesser* of 8/52 of 2019 compensation or \$15,385 per individual *in total across all businesses*.<sup>6</sup> Schedule C filers are capped by the amount of their owner compensation replacement, calculated based on 2019 net profit, and owner-employees by the amount of their 2019 employee cash compensation and retirement and health care contributions made on their behalf. General partners are capped by the amount of their 2019 net earnings from self-employment (reduced by claimed Section 179 expense deduction, unreimbursed partnership expenses, and depletion from oil and gas properties) *multiplied by 0.9235*.

## Nonpayroll Costs Eligible for Loan Forgiveness

As with payroll costs, eligible non-payroll costs include expenses that are either paid or incurred during the covered period—provided incurred expenses are paid on or before the next regular billing date. The rule clarifies that borrowers may seek forgiveness for non-payroll expenses incurred prior to the covered period if paid in the covered period, *e.g.*, when a borrower pays the May electricity bill in June when the covered period also began in June. The SBA reiterates that advance payments of interest on mortgage obligations and principal on mortgage obligations are not eligible for forgiveness under any circumstances—presumably, this restriction would apply to rent as well.

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<sup>5</sup> Client Alert available at: <https://www.huntonak.com/en/insights/worth-the-wait-the-paycheck-protection-program-forgiveness-application-finally-arrives.html>.

<sup>6</sup> See [85 FR 21747, 21750](#).

## Reductions to Loan Forgiveness Amount

Much of this IFR covers curtailing a borrower's loan forgiveness amount based on reductions in full-time equivalent employees or in employee salary and wages during the covered period. An in-depth analysis of the specific details are beyond the scope of this client alert, but we strongly advise borrowers and lenders to carefully review how the statutory forgiveness reduction formulas work and consult with their accountants and advisors.

This IFR provides additional clarity on how borrowers can avail themselves of the safe harbor when an employee declines an offer for rehire or to restore the employee's reduction in hours. In order to meet the safe harbor requirements, there is a new requirement that the borrower informs the applicable state unemployment insurance office of any employees who rejected offers of reemployment within 30 days of rejection of such offers.<sup>7</sup> In addition to this reporting requirement, borrowers must show that they made a good faith, written offer to rehire a recently fired employee (or to restore hours/wages), that the offer was for the same salary or wages and number of hours, that the offer was rejected by the employee, and that the borrower has maintained records documenting the offer and its rejection.

As provided in the Forgiveness Application, a reduction in full-time equivalent (FTE) employees during the covered period reduces the forgiveness amount *by the same percentage as the percentage reduction in FTE employees*. Borrowers can choose from four reference periods in calculating the relevant number of FTE employees. It is admirable that the SBA and Treasury are seeking to provide borrowers with flexibility regarding the reference period, but the complexity is likely to cause significant borrower confusion.

Because the CARES Act does not define the term "full-time equivalent employee," the SBA, in consultation with the Secretary of the Treasury, determined that full-time equivalent means an employee who works 40 hours or more, on average, each week. Borrowers are required to document their average number of FTE employees during the covered period and their selected reference period. Borrowers have two options for calculating full-time equivalency: (1) calculate average number of hours a part-time employee was paid per week during the covered period, or (2) elect to use a full-time equivalency of 0.5 for each part-time employee. Due to the complexity and number of calculations required, many borrowers may elect for the second option—unfortunately this may lead many borrowers to qualify for less than the full potential forgiveness amount.

Additionally, a reduction in an employee's salary or wages in excess of twenty five percent results in a reduction of the loan forgiveness amount, unless an exception applies. The reduction calculations are performed on a *per employee basis*, not in the aggregate. If salary or wage reductions are restored to pre-February 15, 2020, levels, then the borrower may be exempt from any reduction in the loan forgiveness amount. To ensure borrowers are not double penalized, the salary/wage reduction only applies to the portion of the decline in salary and wages that is *not* attributable to the FTE reduction. The IFR contains the following example:

*An hourly wage employee had been working 40 hours per week during the borrower selected reference period (FTE employee of 1.0) and the borrower reduced the employee's hours to 20 hours per week during the covered period (FTE employee of 0.5). There was no change to the employee's hourly wage during the covered period. Because the hourly wage did not change, the reduction in the employee's total wages is entirely attributable to the FTE employee reduction and the borrower is not required to conduct a salary/wage reduction calculation for that employee.*

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<sup>7</sup> The SBA states that additional information regarding how borrowers will report information concerning rejected rehire offers to state unemployment insurance offices will be provided on the SBA's website.

Employees that are fired for cause, voluntarily resign, or voluntarily request a reduction in hours, may be counted at same full-time equivalency level before the FTE reduction when calculating the FTE employee reduction penalty. As described in the next section, borrowers that avail themselves of this safe harbor must maintain records demonstrating that each such employee was fired for cause, voluntarily resigned, or voluntarily requested a schedule reduction.

## Documentation Requirements

The documentation obligations are significant. Incorporating the documentation requirements of the Forgiveness Application by reference, the IFR reiterates that borrowers must submit the required documentation in order to obtain forgiveness. Borrowers are required to submit all payroll, FTE, and non-payroll documentation used to complete the Forgiveness Application (or the lender's equivalent of the application). Additionally, borrowers are required to maintain, and submit upon request by the SBA, documentation supporting the listing of each individual employee listed in the Schedule A Worksheet Tables 1 and 2 of the Forgiveness Application, documentation regarding any employee job offers and refusals, and documentation supporting the FTE Reduction Safe Harbor Worksheet.

As a final catch-all, borrowers must maintain “[a]ll records relating to the Borrower’s PPP loan, including documentation submitted with its PPP loan application, documentation supporting the Borrower’s certifications as to the necessity of the loan request and its eligibility for a PPP loan, documentation necessary to support the Borrower’s loan forgiveness application, and documentation demonstrating the Borrower’s material compliance with PPP requirements.”<sup>8</sup> The retention period for such documentation is six years after the date the loan is forgiven or repaid in full and borrowers must permit authorized representatives of the SBA to access such files upon request.

## IFR on Loan Review Procedures and Related Borrower and Lender Responsibilities

Now that we have covered the first new IFR on loan forgiveness generally, we can turn to the equally significant second IFR that details the procedures and criteria through which the SBA will review initial Triple P loan applications and loan forgiveness applications. This IFR also describes the significant role that lenders will play in the forgiveness decision process.

## Forgiveness Process for Borrowers

The IFR starts with a sweeping statement that the SBA may review **any** Triple P loan of **any size, at any time**, in the SBA’s sole discretion.<sup>9</sup> Such review includes whether a borrower is eligible for the loan based on the provisions of the CARES Act, the rules and guidance available at the time of the borrower’s PPP loan application, and the terms of the borrower’s loan application.<sup>10</sup> Additionally, the SBA may review whether a borrower *calculated the loan amount correctly and used loan proceeds for the allowable uses* specified in the CARES Act. Finally, the SBA may review whether a borrower is entitled to the claimed loan forgiveness amount. As stated in the first IFR, borrowers are required to maintain all required documentation for six years, and lenders are required to comply with the requirements for record retention established by their federal financial regulator.

It appears that the SBA intends to communicate with borrowers through the lenders, but the SBA may also request information directly from borrowers. The lender is responsible for contacting the borrower in writing to request additional information and to provide such information to the SBA when requested.

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<sup>8</sup> See, [SBA Form 3508 PPP Forgiveness Application, page 10](#) (emphasis added).

<sup>9</sup> While the IFR specifically states “any time,” this period is presumed to last for 6 years from the last event, e.g., forgiveness or payoff, considering that is the term of the document retention requirement.

<sup>10</sup> To assist lenders and borrowers with understanding what rules and guidance were in place at what specific date, we have developed a comprehensive timeline available at: <https://www.huntonak.com/en/insights/ppp-timeline-of-important-regulatory-announcements.html>

Borrowers may provide additional information in response to a review and the SBA will consider all information provided by borrowers in response to such inquiries.

Failure to respond to the SBA's inquiry may result in a determination that the borrower was ineligible for a Triple P loan or that the borrower was ineligible to receive the loan amount or forgiveness amount claimed. If the SBA determines that a borrower was ineligible for the loan in the first place, the SBA will direct the lender to deny the forgiveness application. In addition to seeking repayment of the outstanding loan amount, the SBA retains the right to pursue "other available remedies."

### **Forgiveness Process for Lenders**

For all forgiveness applications, lenders are required to: (1) confirm receipt of the borrower certifications contained in the Loan Forgiveness Application; (2) confirm receipt of the documentation borrowers must submit to aid in verifying payroll and non-payroll costs; (3) *confirm the borrower's calculations* on the Loan Forgiveness Application; and (4) confirm the borrower made the calculation on line 10 of the Loan Forgiveness Application. The SBA does reiterate that the borrower is responsible for providing an accurate calculation of the loan forgiveness amount.

Lenders are expected to perform a "good-faith review, in reasonable time, of the borrower's calculations and supporting documents concerning amounts eligible for loan forgiveness." Other than clarifying that a minimal review of calculations based on a payroll report by a "recognized third-party payroll processor" is considered reasonable, the IFR provides no other clarity to give lenders any comfort on what will meet the "good-faith" standard of review. While the IFR stresses that lenders may rely on borrower representations, it also states that lenders are also responsible for working with borrowers when errors are identified in borrower calculations or supporting documents.<sup>11</sup>

Once the lender has received a complete loan forgiveness application, it must issue a decision to the SBA within 60 days. Such a decision may take the form of an approval, in whole or in part, a denial, or a denial without prejudice due to a pending SBA review of the loan for which forgiveness is sought—this denial without prejudice only applies when specifically directed by the SBA.

If the lender decides to approve an application, in whole or in part, it must provide the SBA with the decision along with the following: (1) PPP Loan Forgiveness Calculation Form; (2) PPP Schedule A of the Loan Forgiveness Application; and (3) the optional Borrower Demographic Information Form (if the borrower submits it to the lender). Lenders are required to confirm that the information provided to the SBA accurately reflects the lender's records for the loan and that the lender had made its decision in accordance with the requirements set forth in the IFR. The lender must request payment from the SBA at the time it issues its decision to the SBA. Subject to any SBA review of the loan or loan application, the SBA will 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 provides its decision to the SBA.

When a lender determines that a borrower is not entitled to partial or full forgiveness, the lender must provide the SBA with the reason for its denial. In addition, the lender must provide the three items listed for an approved forgiveness application. The lender must also notify the borrower in writing that the lender has issued a decision to the SBA denying the forgiveness application, again in whole or in part. Borrowers may request that the SBA review the lender's decision pursuant to the SBA's discretionary loan review procedures.

As mentioned above, the SBA may begin a review of any Triple P loan of any size at any time in the SBA's sole discretion. The SBA will notify the lender in writing upon such a review and the lender must notify the borrower in writing within five days of receipt of the notice. Additionally, within five business days, the lender must submit the following: (1) the initial Triple P loan application *and all supporting*

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<sup>11</sup> The IFR provides that: "[Lenders do] not need to independently verify the borrower's reported information if the borrower submits documentation supporting its request for loan forgiveness and attests that it accurately verified the payments for eligible costs."

*documentation provided by the borrower; (2) the Loan Forgiveness Application, and all supporting documentation provided by the borrower; (3) a “signed and certified transcript of account;” (4) a copy of the executed note for the Triple P loan; and (5) “any other documents related to the loan requested by the SBA.”* Note that all such documentation must be provided by the lender electronically to the SBA—no such electronic requirement exists for borrowers when submitting their documents to the lender.

### **Lender Fees**

If the SBA determines that a borrower is ineligible for the Triple P loan, the lender is not eligible for a processing fee for that loan. All processing fees are subject to clawback for a period of one year after the loan was disbursed based on the rules and guidance *available at the time of the borrower’s loan application*, or the terms of the loan application. A determination of borrower eligibility will have no effect on the SBA guaranty if the lender has complied with its obligations under existing rules and guidance.

If a lender fails to satisfy any of its obligations under the Triple P rules and guidance, the lender’s processing fees are subject to clawback. These obligations include all of the document collection and retention requirements described above. The SBA may seek repayment of the lender processing fees and may determine that the loan is not eligible for the guaranty. This clawback does not have a stated period, so lenders may have to worry about potential SBA investigation for the foreseeable future.

### **Next Steps**

There are essentially three options for lenders to consider as we enter the forgiveness portion of the Triple P: (1) wait to see if there will be a legislative fix in the House or in the proposal Senator Rubio is drafting—there are still a couple of weeks before the earliest loan recipients are eligible for forgiveness, legislation likely to pass would significantly change eligible Triple P use of proceeds, and thus forgiveness calculations;<sup>12</sup> (2) continue supporting the program with existing resources, but as we have noted previously, move borrower interaction (and forgiveness application reviews) out of credit administration; or, (3) consider technology solutions to support processing forgiveness applications. Contrary to what the SBA and Treasury seem to think, lenders have a lot of important matters to attend to other than the Triple P.

Considering the record retention requirements and that the SBA expects lenders to be able to provide digital versions of all documents that must be submitted upon request, some lenders may be starting to lean towards procuring one of the many third-party services that are being marketed. It is critical to evaluate solution providers carefully and negotiate unique provisions in the contract prior to signing a new agreement. We have highlighted some of the primary considerations in a recent [client alert](#)—please note that there are various other important items to consider in light of the new Forgiveness Rules that are not addressed in this prior alert.<sup>13</sup> The importance of adequate provisions for indemnification, representations and warranties, as well as insurance, among various other crucial terms, cannot be overstated with respect to the forgiveness portion of the Triple P. At a minimum, solution providers must agree to rerun calculations assuming the Triple P continues to change, as borrowers provide more information and to address borrowers changing applications to see if taking advantage of the program’s flexibility might yield a different outcome.

If you want to share concerns regarding the new Forgiveness Rules, contact your trade group representatives and consider submitting a letter directly to the SBA—comments can be submitted through the Federal eRulemaking Portal, <http://www.regulations.gov>, or by emailing the SBA at [ppp-ifr@sba.gov](mailto:ppp-ifr@sba.gov). Contact us if you would like our assistance with a model letter to the SBA or to borrowers.

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<sup>12</sup> On May 21, 2020, the Independent Community Bankers Association proposed that forgiveness be assumed for loans of \$1 million or less upon receipt of the borrower certifications.

<sup>13</sup> Client Alert: Leveraging Technology for the SBAs Paycheck Protection Program, available at: <https://www.huntonak.com/en/insights/leveraging-technology-for-the-sbas-paycheck-protection-program.html>

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