Overview
For additional guidance, please refer to Steptoe’s COVID-19 Resource Center.

The Coronavirus Aid, Relief, and Economic Security Act (the CARES Act) appropriated over $2 trillion to enhance liquidity in the financial system and stabilize US businesses in the wake of the COVID-19 crisis. Small businesses were a central component of the stimulus package with an initial appropriation of nearly $350 billion. On April 24, the president signed the Paycheck Protect Program and Health Care Enhancement Act (dubbed Phase 3.5 of the stimulus package), which provides an additional $310 billion to further support small businesses.

As even the best laid plans can go awry, many would-be borrowers are waiting empty-handed, which has thrust lending institutions into the cross hairs of unfavorable public sentiment, the plaintiffs' bar, and Congressional inquiries. The resulting news headlines, nationwide litigation, and intense public scrutiny underscore the need for financial institutions to take special precautions and affirmative steps to protect against potential reputational harm and related legal and regulatory risks.

The "Lender Beware" Series
This client alert is part of a "lender beware" series to help financial institutions manage, limit, and address these special considerations and risks, and follows on the heels of our "borrower beware" series and webinar, which highlighted issues for borrowers. Steptoe's cross-disciplinary practice groups, ranging from financial services and commercial litigation to criminal defense and government affairs, are working collaboratively to help participating financial institutions navigate these challenges and avoid undue attention for stimulus funding shortcomings.

This alert highlights certain "rules of the road" for participating lenders doling out CARES Act financial assistance and previews some of the attendant issues and risks. Our "lender beware" series will culminate on May 6 with a webinar addressing these key issues and considerations. Click here to register for the webinar.

The Paycheck Protection Program
The Paycheck Protection Program (PPP) authorized the lending of $349 billion of taxpayer funds to small businesses with 500 or fewer employees, for the purposes of job retention, maintaining payroll costs (including benefits), and other essential expenses such as rent, mortgage interest, and utilities. The CARES Act provides that as long as borrowers can certify they used their PPP loans to keep 75% of their employees on the payroll, the loans will be converted into grants.
Understandably, borrowers flocked to the PPP, and by April 16, the program’s $349 billion appropriation was exhausted. On April 24, the president signed Phase 3.5 of the stimulus package, which provides an additional $310 billion in funds to the PPP.

**Congressional Intent**

The legislative history of the CARES Act reveals that Congressional intent for the PPP was twofold: (1) to aid struggling small businesses in keeping their workers paid and doors open; and (2) to get the necessary funds in the hands of small business owners as quickly as possible.

The need for swift action within the halls of Congress was palpable; by the time the Senate passed the CARES Act on March 25, many small businesses across the country had either already closed or were facing imminent closure without immediate government intervention. This was reflected in contemporaneous legislative statements. For example, Sen. Collins reminded her colleagues that, “[t]ime is not on our side.” And many senators echoed her concerns, sharing stories of struggling small businesses in their respective states.

**The PPP’s Lender Requirements**

Borrowers can access SBA loans only through an intermediary: lending institutions. The CARES Act authorizes lending institutions, including existing SBA-certified lenders and certain federally insured depository institutions, to speedily process PPP loans. Non-bank and non-insured depository institution lenders can also process PPP loans once they are approved and enrolled in the program. Phase 3.5 will expand the original pool of potential lenders by setting aside funds to entice smaller lenders to participate; of the additional $310 billion, $30 billion is reserved for community-based lenders, small banks, and credit unions, and another $30 billion will go to mid-sized banks and credit unions.

Given Congress’ intent that the SBA provide relief to America’s small businesses expeditiously, the CARES Act streamlined the borrower vetting requirements of the regular SBA section 7(a) loan program. Examples of these accelerated directives include the following:

- The SBA does not require loans made under the PPP to comply with SBA section 120.150 “What are SBA’s lending criteria[,]” which normally requires participating financial institutions to engage in a slew of inquiries and evaluations to explore the soundness of a loan. Instead, the SBA allows lenders to rely on the borrower’s own certifications in order to determine the borrower’s eligibility for and use of loan proceeds.
- The SBA allows CARES Act lenders to rely on specified documents provided by borrowers to determine the qualifying loan amount and eligibility for loan forgiveness, without the need for these lenders to conduct an independent verification of those documents.
- Lenders can rely on borrower certifications with little risk; as the PPP Interim Final Rule states, “the Administrator will hold harmless any lender that relies on such borrower documents and attestation from a borrower.”
- Moreover, in an effort to process loan applications quickly, lenders need not collect, certify, or re-verify beneficial ownership information of existing customers seeking a PPP loan, regardless of whether they have collected that information in the past. (Click here for more FAQs).
- Finally, the Interim Final Rule describes the PPP as “first-come first-served” – but falls short of including an express requirement that lenders process applications in that manner. Phase 3.5 does not materially alter these rules.

Despite the liberal discretion and procedural shortcuts the CARES Act permits lenders to exercise when processing borrowers’ PPP applications, criticism of lenders’ handling of this process has already emerged within recent days. The less rigorous borrower vetting process Congress wrote into the Act for expediency has led to collateral consequences, leaving some questioning whether lenders accepted applications from borrowers that were either unqualified, or for whom the loan program arguably was not intended, even if the borrowers land within the literal scope of the CARES Act. Additionally, the fact that the PPP did not require lenders to spend time re-verifying existing clients’ information has raised questions about whether those applications were fast-tracked, sending earlier-in-time applicants toward the back of the line.

**Lender Compensation**

The CARES Act directs the SBA to compensate lenders who process PPP loans. Fees are not supposed to be collected from applicants. Lender compensation amounts vary according to the following schedule:

- 5% for loans less than or equal to $350,000
- 3% for loans between $350,001 and $1,999,999
- 1% for loans greater than or equal to $2 million (up to the maximum loan award of $10 million).
Consistent with Congress' intent to get money into the pockets of small businesses (and in turn their employees) as quickly as possible, the PPP's compensation schedule encourages lenders to quickly process a high volume of loans. Others have argued, however, that the PPP's fee schedule also provides a financial incentive to lenders who distribute larger loans. Questions as to whether this graduated fee schedule has caused some lenders to prioritize the processing of larger businesses' applications over smaller ones have already sparked controversy.

A Storm is Brewing

These circumstances – many of which could have been avoided with more specific legislation and implementing regulations – have forced lending institutions facilitating small business loans to deal with unique issues and risks.

For instance, while SBA lending rules for the CARES Act have been relaxed and lenders have been exempted from many underwriting formalities, the scope and nature of these protections and exemptions are riddled with uncertainty. For example, it is unclear how rules holding lenders harmless in connection with the CARES Act intersect with Know-Your-Customer and Anti-Money Laundering considerations. Nor is it clear how a bank must evaluate an application when the bank possesses institutional knowledge, based on a long-standing relationship with the borrower, that the borrower's certifications are deficient.

With respect to lender liability to borrowers, the CARES Act does not explicitly provide for a private cause of action, but it does not exempt lenders from such liability either. Seizing on this uncertainty, dissatisfied would-be borrowers have already argued for an implied right of action to sue lenders under the CARES Act. Moreover, the CARES Act does not contain an express preemption provision, leaving open the possibility of litigation brought under state law.

Moreover, the government’s failure to directly and adequately address the concerns of small businesses that applied for funds has also escalated a rallying cry to deal with unique issues and risks underlying participation in the program. One source of this criticism is Sen. Rubio, who backed the original program. In a letter he sent to the chief executive officers of several large banking institutions, Sen. Rubio questioned whether lenders participating in the PPP processed applications in a neutral manner.

Similarly, Democratic members of the House of Representatives, led by Rep. Judy Chu, chair of the House Small Business Subcommittee on Investigations, Oversight, and Regulations, and Committee Chairwoman Nydia M. Velázquez, penned a letter to Treasury Secretary Steven Mnuchin and SBA Administrator Jovita Carranza urging new rules for the PPP. The representatives state that, although the PPP was intended to "help small businesses survive the coronavirus crisis without having to let go of staff," Congress "did not include any rules to prohibit exclusionary or inequitable practices." As a result, according to the representatives, "the nation's largest banks limited applications to only their highest-value existing business customers, excluding the majority of small businesses – including many of their current customers."

Frustrated applicants have followed Congress' lead and have already begun blaming lending institutions for the funding shortfall. In the last two weeks, multiple class action lawsuits alleging implied rights of action under the CARES Act, as well as a variety of fraud, deceptive practices, and contract-based claims based on state statutory and common law, have been filed against many of the nation's largest lending institutions.

These trends are particularly troublesome given that the PPP rules are constantly changing. Acceptable lending practices one day may be prohibited the next. Additionally, as the focus gradually shifts from the lending of funds to repayment and forgiveness issues, additional uncertainty and a lack of clear guidelines will continue to raise issues for lenders.

Practical Approach to Mitigating Risks

Lenders processing PPP applications under Phase 3.5 of the stimulus package need to be aware of these issues and risks underlying participation in the program. Additional installments in this "lender beware" series will explore recent allegations and lawsuits levied against participating lenders and highlight related civil and criminal risks. Lenders would be well-advised to develop a working understanding of these issues, update compliance materials, reevaluate employee training, and consult with knowledgeable counsel with cross-disciplinary experience dealing with crisis funding issues.
CLIENT ALERTS
Lender Beware Series - Part II: Key Sources of Civil Liability
April 29, 2020
By: Leah M. Quadrino, Stacie R. Hartman, Matthew B. Kulkin, Patrick F. Linehan, Michael Campion Miller, Ashwin J. Ram, Jeremy B. Glen, Caitlin Conroy, Jason Meade, Anna M. Stressenger

CLIENT ALERTS
Lender Beware Series - Part III: Criminal Exposure for Banks Participating in the CARES Act
May 5, 2020
By: Michael Campion Miller, Stacie R. Hartman, Matthew B. Kulkin, Leah M. Quadrino, Ashwin J. Ram, Jeremy B. Glen, Jason Meade, Caitlin Conroy, Anna M. Stressenger

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