Client Alert

April 2020

Catching Our Breath: Paycheck Protection Program Assessment as of April 20, 2020

The first $349 billion of funding under the Coronavirus Aid, Relief and Economic Security Act ("CARES Act") for the Paycheck Protection Program ("Triple P") has now been allocated. The Small Business Administration ("SBA") has now stopped accepting applications under the Triple P until its funding is replenished. Although perhaps not desirable, this respite provides financial institutions with an opportunity to take stock of the Triple P to date, prepare for the next round of funding that will invariably follow under the program and assess transitioning back to regular business. Institutions that are the most successful at leveraging their performance under the Triple P and also transitioning away from it are likely to be better positioned for the economic challenges to follow.

I. Triple P Round I

The SBA has released statistics regarding activity under the Triple P. The average funded loan was approximately $206,000. There were 1,229,893 loans that were $150,000 and under. This represented approximately 74% of loans funded and approximately 17% of the amount funded. Similarly, loans between $150,000 and $350,000 were an additional 224,061 loans and approximately $51 million in dollars funded. The full statistics by loan size and count are as follows:

Triple P Loan Size Summary

Loan Size	Approved Loans	Approved Dollars	% of Count	% of Amount
$150 and Under	1,229,893	$58,321,791,761	74.03%	17.04%
>$150K - $350K	224,061	$50,926,354,675	13.49%	14.88%
>$350K - $1M	140,197	$80,628,410,796	8.44%	23.56%
>$1M - $2M	41,238	$57,187,983,464	2.48%	16.71%
>$2M - $5M	21,566	$64,315,474,825	1.30%	18.79%
>$5M	4,412	$30,897,983,582	0.27%	9.03%

Source: SBA

Triple P Lenders – Highest Approved Dollars – Top 5

Lender	Approved Loans	Approved Dollars	Average Approved Size
1	27,307	$14,071,396,427	$515,304
2	32,097	$10,309,843,746	$321,209
3	21,062	$9,612,090,368	$456,371
4	33,594	$7,778,303,458	$231,538
5	27,929	$6,555,028,971	$234,702

Approvals through April 16, 2020. Source: SBA

There were 4,975 lenders that participated in the Triple P with gross loan dollars of $342,277,999,103. The difference between the gross loan amount and the $349 billion dollars that Congress had appropriated represented the origination fees to the lenders of approximately $6.722 billion dollars.

Community banks performed extremely well. Banks of under $1 billion dollars in total assets funded 20% of all of the Triple P loans. Lenders under $10 billion dollars in assets funded 60% of all the Triple P loans. Perhaps the manual nature of the E-Tran system and the one-week head start that banks received gave them a performance leg up. What seemed to make the most difference as to whether small businesses, religious organizations or non-profits received funding was whether they had a relationship with the lender. Accordingly, the community banks may have been best positioned to leverage their service model to shepherd customers through the program.

It has been some time since banking was so personal, intimate and desperate. Banks were able to add new customers and provide a lifeline to some grateful existing ones. Bank marketing, social media and service practices can be expected to expand on such beachheads. Time will tell if small businesses will remember the value of the ability to make a phone call rather than just engage digitally with a chatbot.

So what comes next?

II. Continue to Fund

a. Distribution Deadline. On April 8, 2020, the SBA indicated that loans need to be funded within 10 days from the date of approval. These are calendar days. Accordingly, lenders need to continue to complete their origination efforts by timely funding the loans.

   Because some lenders are funding the loans to existing bank accounts, they need to be sure to communicate (ideally on the same day) when the loan is actually funded. Borrowers have strict restrictions on use of proceeds within requisite timeframes. Lenders that lapse in their communication can diminish the goodwill established from facilitating customers in obtaining loans.

b. Obtain SBA No. On the day the loan is funded, indicate such in the SBA system. In addition, make sure to indicate the loan customer and the loan amount on the monthly 1502 form. Be aware that the borrower name and amount borrowed will be publicly released by the SBA.

c. Agents. The Triple P is vague regarding the role of agents. As a result, third parties such as accountants, lawyers and insurance agents have been sending invoices to lenders. The claims have equaled the maximum amount provided for under the CARES Act. Applicants should certify that they have not used an agent. When agents are legitimately involved in the process, lenders should negotiate fees. Lenders should seek to have read into the Triple P the requirement that agents complete Section 7(a) Form 159. Lenders could use such form to push back against agent windfalls.

d. Get Ready for Round II. As discussed below, Congress can be expected to add additional funds to the Triple P. Lenders should be prepared to address the next, albeit smaller, wave.

III. Assess Performance

a. Quality Control ("QC"). Initial funding under the Triple P was chaotic and subject to shifting rules. The borrower application changed the day the E-Tran system opened to applications. As the process evolved, lenders added certifications/hold harmless forms. Seasoned 7(a) lenders used their form notes early on. Data input initially required up to 75 minutes and the E-Tran system crashed periodically. Electronic signatures were necessary. Moreover, the program involved manual data entry.

Such issues increased the prospects for errors. It is likely that there were missed signatures and lost service paperwork. In short, it is worthwhile for financial institutions to engage in QC on at least a sample basis to identify deficiencies. Borrowers will want to obtain at least partial forgiveness for their loans. The forgiveness subsequent interaction provides another opportunity to correct the file.

b. Debrief. Financial institutions should take the opportunity presented by the Congressional funding delay to debrief regarding what worked in the process and how to fine-tune processes.

c. Outreach. Money center banks, Fintech lenders and others continue to take applications for the next round of financing. All financial institutions should continue to do so. Ideally, financial institutions will engage in outreach to identify would-be customers.

Independent contractors were only allowed to participate in the Triple P three business days before funding ran out. Restaurants[1] (which comprised only approximately 5% of funded applications) and smaller businesses and non-profits lacked the sophistication to access the Triple P early enough. There is certainly additional opportunities to add customers and line them up. Obviously, it will be important to employ proper certifications regarding risk that funding may not become available.

d. Who was Left Out?

Analyze what businesses may have been left out. The “Sense of Congress” was that minority-owned businesses and businesses of only two years owned by women would have at least equal access to funding. The new legislation may actually leap-frog them to the front of the line. Outreach to such organizations will be helpful. It can be expected that the House of Representatives will require more effort to gain support for additional funding.

Lenders should also keep apprised of what other groups may join the queue. For instance, the Diocese of Rochester NY and Buffalo NY (both Chapter 11 debtors) sued the SBA seeking injunctive relief to allow them access to the Triple P. If successful, the SBA might need to allow debtors in bankruptcy to participate.

In short, so many would-be borrowers missed out when the music stopped that lenders would do well to consider who else might need a chair.

e. Understand Borrower Alternatives

The SBA has stopped accepting applications under the Economic Injury Disaster Loan (“EIDL”) COVID-19 related assistance program (including EIDL Advances). The EIDL has also run out of funding. The EIDL, too, can be expected to be replenished.

Bankers need to be able to counsel customers regarding available alternatives. Accordingly, bankers need to be able to articulate advantages of Triple P loans (such as loan forgiveness) as well as what aid can be combined. There also may be potential assistance available in other forms, such as state programs (we have a list of programs offered by each state upon request). For instance, the SBA will

[1] Assuming a second round of Triple P funding, restaurants may actually benefit from a delay in receipt of load proceeds. Closing the gap in time between when civil authority orders are rolled back and when funds must be taken could enhance loan forgiveness.

automatically pay the principal, interest and fees on "current" 7(a), 504 and microloans for six months under section 1112 of the CARES Act.

The SBA will pay the principal, interest, and any "associated fees" that borrowers owe to 7(a) lenders and Certified Development Companies ("CDCs") for a six-month period. For the first monthly payment, lenders must provide the requisite information regarding existing section 7(a) loans no later than April 22, 2020. The SBA will send the first payments out on or before April 30, 2020.

IV. Forgiveness.

a. Data Collection. The SBA has indicated that it will publish more information regarding the forgiveness process. Nonetheless, lenders should be compiling information regarding expected staffing activity of borrowers as well as the following information:

- FTEs as of February 15th and as of the date of the application;
- date of funding; and
- date that the eight-week forgiveness period ends.

This will be quite useful in estimating forgiveness.

b. "Tracing Funds"

Below is a working list of "do's and don'ts" with respect to the loan proceeds, which includes an overview of what the proceeds can be used for and a list of gray areas that may be fact-specific.

TRIPLE P FUND USAGE		
DOs	**DON'Ts**	**GRAY AREAS**
○ salary, wages, commissions ○ cash tips or the equivalent ○ payment of vacation, sick, parental/family/medical leave ○ payment of retirement contributions, group health coverage premiums ○ state and local taxes assessed on payroll ○ interest on mortgage obligations, rent, and utilities that were in use before February 15, 2020 ○ interest on other debt obligations incurred before February 15, 2020 ○ allowance for dismissal or	○ federal payroll tax, including employer's share of FICA and Railroad Retirement Act taxes ○ compensation paid to employees in excess of $100,000 ○ compensation paid to employees domiciled outside the U.S. ○ any prepayment of or payment of principal on a debt obligation ○ amounts paid to an independent contractor ○ qualified sick leave wages or family leave	○ workers' compensation-related fees ○ Prefunding of discretionary profit sharing contributions to retirement plan ○ Payment of plan expenses of the retirement plan, whether pre-funded or not ○ Essentially: Will "any" payment to a retirement plan within the eight-week window qualify as "payroll costs" for purposes of the loan forgiveness?

separation ○ Refinancing of SBA disaster loans incurred between January 3, 2020 and April 3, 2020	wages for which a credit is allowed under sections 7001 or 7003 of the Families First Coronavirus Response Act	

Regardless of the forgiveness period, 75% of the loan proceeds must be used to cover payroll.

c. Develop a Forgiveness Calculator. Lenders should convert the below chart into their own excel calculator.

	Triple P Loan Forgiveness Calculator	
1.	**Triple P Amount Borrowed**	
2.	**Payroll Costs – First Eight (8) Weeks After Loan Funding[1]**	
	Payroll Costs[2]	
	Salaries, wages, commissions, payment of vacation, sick parental, family and medical leave	
	Cash tips or the equivalent	
	State/local taxes on employee compensation	
	Group health care premiums (see above chart)	
	Retirement benefits (see above chart)	
	Potentially Forgivable Payroll Costs	
3.	**Forgivable Nonpayroll Expenses – First Eight (8) Weeks[3]**	
	Rent	
	Utilities	
	Mortgage interest	
	Interest on other debt	
	Potentially Forgivable Nonpayroll Expenses	
4.	**Maximum Amount That May be Forgiven**	
	Actual Amount That May be Forgiven (subject to reduction)	
5.	***LESS: Reduction Based on Number of FTEs Cuts:***	
	Monthly Average FTEs for the First Eight (8) Weeks	
	Monthly Average FTEs for 2/15/19 to 6/30/19 or 1/1/20 to 2/29/20	
	% Reduction in Workforce	____%
	LESS: Reduction Based on Salary and Wages Cuts:[4]	
	Reduction in Salary/Wages on a per-Employee Basis? Compared to Most Recent Full Quarter	
6.	**Borrowers may be able to avoid such reductions if it can eliminate the shortfall by June 30, 2020**	
7.	**Forgiveness Amount**	
8.	**Remaining Loan Amount**	

1 Exclude portion of payroll for employees above $100,000 and independent contractors.

[2] At least 75% of the loan proceeds must be used for payroll costs, regardless of timing.
[3] No more than 25% of loan proceeds may be used for nonpayroll expenses.
[4] Exclusion for portions of compensation may not be applicable (or may be reduced if under $100,000) if remainder is still over $100,000.

If lenders choose to share this calculator with borrowers, lenders should inform borrowers that they are responsible for accurately documenting and calculating loan forgiveness amounts.

Borrowers will need to prove up forgiveness based, in part, on Form 941 and state quarterly wage unemployment insurance tax reporting forms or equivalent payroll processor records that correspond to the applicable time frame (along with proof of retirement and health insurance contributions). Borrowers will also need to submit proof of business rent, mortgage insurance on real or personal property and utility payments if funds were used for such purposes.

Lenders should consider creating a comparable calculator for independent contractors, nonprofits and partnerships.

d. Expected Forgiveness. After seven weeks from loan funding, the lender can advise the SBA of the expected forgiveness amount. The SBA has 15 days to acquire that part of a loan. If the SBA system allows, the lender should include the accrued interest to that time as well as the interest that would continue to accrue up until the point the loan is due to be forgiven. The SBA has not yet released what documentation will be required for advance purchases of the expected forgiveness amount.

e. Eight Weeks. After eight weeks, the forgiveness information will be final. The lender can verify the estimates provided to the SBA and supplement the request made. Because the SBA has 15 days from when the notice of expected forgiveness amount is provided to acquire a portion or all of the loan, by giving the notice based on the expected forgiveness amount rather than the actual amount, the lender may shorten the time period of ultimate SBA payment (down to eight days from when the actual amount is fixed).

V. Funding and Capital

PPPLF. For the first time, the Federal Reserve has created a long-term fixed-rate credit facility. The Paycheck Protection Program Lending Facility ("PPPLF") is designed to allow match funding of the Triple P credits. The interest rate on PPPLF lending arrangements are reserved for financial institutions at 35 bps for the two-year term of the Triple P.

Because the PPPLF is established under section 13(3) of the Federal Reserve Act, a financial institution borrowing thereunder "must certify that it is unable to secure adequate credit accommodations from banking institutions." Because such language cannot be modified, the Federal Reserve issued FAQs that provide "[i]n particular, a PPPLF participant may rely on the fact that the Board of Governors authorized the establishment of the PPPLF to improve the ability of PPP lenders to obtain reasonably priced long-term financing for PPP loans."

Contemporaneous with the announcement of the PPPLF, federal bank regulators announced that Triple P loans pledged to the Federal Reserve would not be deemed outstanding for capital ratio purposes, including under the leverage ratio. Thus, with a stroke of the pen, the Triple P loans would not exist for liquidity and capital purposes. Such regulatory pronouncements reinforce that, at its core, the Triple P was intended to function as a modified grant program.

FHLB. The Federal Home Loan Banks ("FHLBs") have introduced a funding facility that it hopes will remain attractive. Specifically, the FHLB is providing advances of 25 bps for six months. The FHLBs recognize that such facilities lack the attractive capital treatment as offered in conjunction with the PPPLF. As of this client alert date, the FHLBs were seeking comparable capital relief for their advances, but have not yet succeeded in such efforts.

Nonrecourse. Interesting, the PPPLF may address the "tail risk" of the Triple P. Triple P loans pledged to a Federal Reserve Bank are on a nonrecourse basis. Other than default of the underlying borrower or partial or full Triple P loan forgiveness, the PPPLF loan term is equal to the two-year term of the Triple P loans. Could financial institutions simply walk away from their loan from the Federal Reserve Banks? The Federal Reserve Bank, the SBA and the underlying borrower would then need to work out Triple P credits. Absent an SBA change in the Triple P, there is no incentive for lenders to service such loans beyond two years.

VI. Transitioning

a. Staffing. The E-Tran system was extremely hard to manage. The *New York Times* reported that applications initially required 25 to 75 minutes. In contrast, the new Amazon web services-based system that the SBA has adopted in recent days, requires only five minutes to complete an application. We believe now is the time to start transitioning loan officers out of their roles in the Triple P and replace such workers with analysts, loan secretaries, marketing personnel and other individuals. Such a change would enable loan officers to focus on workout arrangements with other customers experiencing challenges from the current circumstances.

b. Loan Modifications, Appraisals and Forbearance. Banks will need to turn to the unhappy business of addressing borrowers beyond the Triple P stopgap. GDP estimates for the second quarter of 2020 are unfathomable.

Firm	2Q2020 GDP estimate
Bloomberg Economics	-9.0%
TSLombard	-17.7%
Wells Fargo	-22.3%
Cornerstone Macro	-25.0%
JPMorgan	-25.0%
UBS	-25.5%
IHS Economics	-26.5%
Bank of America Merrill Lynch	-30.0%
Oxford Economics	-32.0%
Deutsche Bank	-33.0%
Strategas	-33.3%
Credit Suisse	-33.5%
Goldman Sachs	-34.0%
Barclays	-35.0%
Morgan Stanley	-37.9%
Capital Economics	-40.0%
Evercore ISI	-50.0%

Source: Charles Schwab

Lenders will need to determine whether their customers were damaged, but repairable, or whether they were mortally wounded by the civil orders to address COVID-19. This fundamental calculation will determine the ultimate course of action. We encourage bankers to access the mid-March ICBA webinar Neil Falken of Clifton Larson Allen and Peter Weinstock presented on this topic.

c. ALLL. Financial institutions should be increasing the direction of provisions to the allowance for loan losses (ALLL) consistent with the direction of risk. Increases to the ALLL can be made up until the first quarter Call Report is filed. The Triple P provides financial institutions with significant one-time earnings. Although Triple P earnings have nothing to do with the ALLL, hopefully such profits enhance the willingness to make higher provisions.

VII. Final Thoughts

The pause between the allocation of Triple P dollars and new Congressional funding offers bankers the opportunity to assess their situation. Although the natural tendency is simply to rest and catch a breath, this valuable respite should be used both offensively and defensively.

Once new funding is allocated, lenders will need to move fast as it is likely the next round will run out even quicker than the first. This is largely due to lenders now being prepared as it took several days for many to get up to speed, particularly for those that were not already approved SBA lenders. Last week, various nonbank lenders entered the mix, including PayPal, Square and Intuit. These nonbank lenders are expected to leverage their large business customer base and ability to automate the loan process to originate loans at a rapid pace. Additionally, several large banks have continued to accept Triple P applications even after funding ran out and will likely have a large inventory ready to process as soon as more funding is allocated.

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