

COVID-19 - Expanding Opportunities for SBA Lending

April 2, 2020 | [Katherine C. Fisher](#) and [Catherine M. "Cathy" Brennan](#)

Congress has responded to the economic crisis brought on by the COVID-19 virus by passing economic stimulus packages to help small and mid-sized businesses. Congress included in the CARES Act \$349 billion for Paycheck Protection Program Loans ("PPP Loans") that will allow businesses with up to 500 employees ("Covered Businesses") to obtain business-purpose loans and, in certain instances, not repay. This article provides information on how lenders can apply to become Small Business Administration ("SBA") approved lenders ("SBA Lenders") to extend PPP Loans to Covered Businesses.

I. Background

The SBA is a federal government agency that supports small businesses by increasing access to capital, offering business counseling, and helping small businesses win government contracts. The SBA does not lend money itself - it sets standards under different loan programs that SBA lenders must follow, and the SBA guarantees a portion of those loans in the event of default by the borrower. Those guarantees incentivize lenders to extend credit to eligible small businesses. Nearly all SBA lenders are financial institutions such as state- and federally-chartered banks.[1] However, the CARES Act includes a provision that will expand opportunities for non-bank lenders to make PPP Loans.

II. How to Apply to Become an SBA-Approved Lender

Yesterday, the U.S. Treasury Department released guidance that included an e-mail address for a new lender to apply to become an SBA-approved lender.[2] However, there is not yet publicly available guidance on revised requirements for applicants.

III. CARES Act Expanded Lender Opportunities for Paycheck Protection Loans

Any business with up to 500 employees[3] can obtain a PPP Loan. Because of the massive scope of the PPP Loans, the CARES Act instructs the SBA and Secretary of the Treasury to allow other types of financing institutions to make PPP Loans.[4]

The Treasury Department, in consultation with the SBA, must establish criteria for lenders that do not already originate SBA loans to originate PPP Loans until the COVID-19 national emergency expires.[5]

Any lender of PPP Loans must have the necessary qualifications to process, close, disburse and service loans made with the guarantee of the SBA. A lender may only participate in making PPP Loans if its participation does not affect the safety and soundness of the lender, as determined by the Treasury Department. The Treasury Department may issue regulations and guidance as necessary, including to:

- Allow additional lenders to originate PPP Loans; and
- Establish terms and conditions for PPP Loans, including terms and conditions concerning compensation, underwriting standards, interest rates, and maturity.[6]

Accordingly, the Treasury Department must act to establish guidelines to expand the pool of approved SBA lenders. The Treasury Department has stated publicly that PPP Loans will be available by Friday, April 3, 2020, however, the PPP Loans could begin without additional lenders.[7]

IV. SBA Purchases of PPP Loans and Lender Liquidity Issues

To help SBA lenders originate PPP Loans, the CARES Act requires the SBA to purchase PPP Loans with certain characteristics, as follows.

Payment Deferrals. A lender must allow a borrower to defer payments of principal, interest and fees for at least 6 months and up to a year. For PPP Loans that are sold on the secondary market, if an investor declines to approve an at least 6-month deferral of payments, the SBA must purchase the loans so that the impacted borrower may receive a deferral for a period of not less than 6 months, including payment of principal, interest, and fees, for not more than 1 year.[8]

Loan Forgiveness. In general, the SBA will forgive any loan proceeds a small business spends on payroll costs; mortgage interest payments, rent and utilities. An authorized lender or a third-party participant in the secondary market may report to the SBA an expected forgiveness amount on PPP Loans or on a pool of PPP Loans of up to 100% of the principal amount(s). The SBA must purchase the expected forgiveness amount as if the amount were the principal amount of a loan guaranteed under Section 7(a) of the SBA Act[9] not later than 15 days after the date on which the SBA receives a report.

However, this 15-day period means that a lender must have the liquidity to extend PPP Loans and wait 15 days for some or all of the loans to be purchased by the SBA.

V. Delegated Authority and Limits on Lender Liability

Under prior SBA programs, lenders had to submit application packets to the SBA for approval unless the SBA had granted delegated authority

to the lender.[10] Under the CARES Act, a lender who is approved to make PPP Loans is automatically delegated authority to make and approve those loans.[11]

The CARES Act also limits a lender's liability. If a lender has received the documentation required for loan forgiveness attesting that the borrower has accurately verified the payments for payroll costs, payments on covered mortgage obligations, payments on covered lease obligations, or covered utility payments, no enforcement action can be taken against the lender under section 47(e) of the Small Business Act.[12] The lender also will not be subject to any penalties by the SBA relating to loan forgiveness for the payments of payroll costs, payments on covered mortgage obligations, payments on covered lease obligations, or covered utility payments.[13]

However, the CARES Act expressly provides that PPP Loans are subject to the SBA Act's criminal provisions related to false statements, embezzlement and other crimes.[14] The CARES Act also does not expressly limit the application of the False Claims Act,[15] which has previously been applied to SBA lenders.[16]

VI. Lender Compensation

The CARES Act limits lender compensation under PPP Loans. A lender cannot charge a borrower a fee, such as an origination fee, related to a PPP Loan. However, the SBA will pay the lender a fee based on the balance of the financing outstanding at the time of disbursement of the loan, as follows:

- 5% for loans of not more than \$350,000;
- 3% for loans of more than \$350,000 and less than \$2,000,000; and
- 1% for loans of not less than \$2,000,000.[17]

VII. State Lending Licensing Requirements and Interest Rate Limits Will Still Apply to Non-Bank Lenders

A non-bank lender who obtains SBA authorization to make PPP Loans must still obtain any state-law required licenses to engage in commercial lending.[18] Some of these licenses can take up to a year to obtain in normal times, let alone when state workers are working from home. For example, the California Finance Lenders Law requires a license to make commercial loans to a business located in California, regardless of the size of the loan or the associated interest rate.[19] Wisconsin's Nondepository Small Business Lenders Act requires a license to participate in SBA lending.[20]

In addition, a number of states have maximum interest rate limits for commercial loans, although the 4% per year maximum interest rate allowed for PPP Loans is permissible in all states.

VIII. Current Requirements for SBA Lenders

Existing SBA Lenders originate so-called SBA 7(a) loans, and PPP Loans are merely a type of SBA "7(a)" loan.

There are three types of SBA Lenders: federally regulated lenders (such as banks), SBA-regulated lenders known as Small Business Lending Companies,[21] and approved non-federally regulated lenders ("NFLRs"). Effectively, new SBA lenders would need to qualify as NFLRs or qualify under new guidelines that have not yet been released.

One issue for would-be SBA lenders is that the current rules prohibit a SBA lender from owning an equity interest in a business that has received or is applying to receive SBA financing (during the term of the loan or within 6 months prior to the loan application).[22] Unless revised, this limitation prevents any business who applies for a PPP Loan from making any PPP Loans itself.

The standard SBA lender application process is burdensome and requires significant detailed information about:

- The corporate structure, operations, finances and business plans of the lender;
- All control persons-including fingerprinting for background checks;
- Secondary market operations;
- Licenses, audits, and other regulatory information; and
- Legal actions.[23]

The application also requires a legal opinion from independent counsel regarding compliance with securities laws and certain corporate law issues. To be a qualified SBA Lender, the lender must:

- Have a continuing ability to evaluate, process, close, disburse, service, and liquidate small business loans;
- Be open to the public to issue loans (and not be a financing subsidiary, engaged primarily in financing the operations of an affiliate);
- Be supervised and examined by a state or federal regulatory authority, satisfactory to the SBA.[24]
- Meet the following ethical requirements by not:
 - Self-dealing;
 - Have a real or apparent conflict of interest with a small business with which it is dealing (including any of its associates or an associate's close relatives) or SBA;

- Own an equity interest in a business that has received or is applying to receive SBA financing (during the term of the loan or within 6 months prior to the loan application);
- Be incarcerated, on parole, or on probation;
- Knowingly misrepresent or make a false statement to SBA;
- Engage in conduct reflecting a lack of business integrity or honesty;
- Be a convicted felon, or have an adverse final civil judgment (in a case involving fraud, breach of trust, or other conduct) that would cause the public to question the lender's business integrity, taking into consideration such factors as the magnitude, repetition, harm caused, and remoteness in time of the activity or activities in question;
- Accept funding from any source that restricts, prioritizes, or conditions the types of small businesses that the Participant may assist under an SBA program or that imposes any conditions or requirements upon recipients of SBA assistance inconsistent with SBA's loan programs or regulations;
- Fail to disclose to SBA all relationships between the small business and its Associates (including Close Relatives of Associates), the lender, and/or the lenders financing the Project of which it is aware or should be aware;
- Fail to disclose to SBA whether the loan will:
 - Reduce the exposure of a lender or an Associate of a lender in a position to sustain a loss;
 - Directly or indirectly finance the purchase of real estate, personal property or services (including insurance) from the Participant or an Associate of the Participant;
 - Repay or refinance a debt due a Participant or an Associate of a Participant; or
 - Require the small business, or an Associate (including Close Relatives of Associates), to invest in the Participant (except for institutions which require an investment from all members as a condition of membership, such as a Production Credit Association);
 - Issue a real estate forward commitment to a builder or developer; or
 - Engage in any activity which taints its objective judgment in evaluating the loan.[25]

Entities seeking to originate PPP Loans should consider whether they can meet these requirements, in the event that SBA does not streamline the process for becoming an SBA lender.

IX. Timeline and Next Steps

Because of the urgent need to deploy PPP Loans to Covered Businesses, the Treasury Department and SBA will be under pressure to approve additional lenders. We expect that guidelines for becoming an SBA Lender will be released within the next week.

[1] A list of SBA-approved lenders as of April 2018 is available here <https://www.sba.gov/content/lender-list-april-2018>.

[2] That email address is DelegatedAuthority@sba.gov.

[3] CARES Act § 1102(a)(2)(J).

[4] CARES Act § 1102(a)(2)(F)(iii).

[5] CARES Act § 1109(b).

[6] CARES Act § 1109(d).

[7] See "What's in the just-passed small-business Paycheck Protection Program," *The Business Journals* (March 27, 2020), available at <https://www.bizjournals.com/bizjournals/news/2020/03/29/whats-in-the-just-passed-small-business-paycheck.html>.

[8] CARES Act § 1102(a)(2)(M)(iii).

[9] 15 U.S.C. § 636(a).

[10] 13 C.F.R. § 120.440 (criteria for delegated authority).

[11] CARES Act § 1101(a)(2)(F).

[12] 15 U.S.C. § 657t(e); CARES Act § 1106(h).

[13] CARES Act § 1106(h).

[14] CARES Act § 1109(i).

[15] 31 U.S.C. §§ 3729 *et seq.*

[16] See e.g., <https://www.justice.gov/opa/pr/defense-contractor-ads-inc-agrees-pay-16-million-settle-false-claims-act-allegations>

[17] CARES Act § 1102(a)(2)(P).

[18] We do not address choice of law lending models in this memorandum.

[19] Cal. Fin. Code §§ 22009, 22100.

[20] Wis. Stat. §§ 224.90 *et seq.*

[21] There are only 14 Small Business Lending Companies, and it is unlikely more will be authorized. As a result, the only way to become a Small Business Lending Company is to acquire one and that acquisition must be approved by the SBA. *Lender and Development Loan Programs*, SBA, SOP 50-10-5(k) p. 41 (April 1, 2019) *available at* <https://www.sba.gov/sites/default/files/2019-02/SOP%2050%2010%205%28K%29%20FINAL%202.15.19%20SECURED%20copy%20paste.pdf>

[22] 13 C.F.R. § 120.140.

[23] SBA, SOP 50 10 5(K) (April 1, 2019).

[24] 13 C.F.R. § 120.410; <https://www.sba.gov/partners/lenders/become-sba-lender>.

[25] 13 C.F.R. § 120.140.

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410.684.3200

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