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Senate passes H.R. 7010 amending the Paycheck Protection Program

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On the evening of June 3, the Senate passed H.R. 7010, titled the "Paycheck Protection Program Flexibility Act of 2020," which amends the Paycheck Protection Program ("PPP") as originally enacted on March 27 by the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"). President Trump is expected to sign the bill into law in the coming days.

Generally speaking, the amendments to the PPP effected by the bill will increase the amount of forgiveness of PPP loans, which will in turn decrease the number and principal balances of loans on banks' books following the forgiveness period. However, much of this forgiveness will not occur until early 2021, requiring banks to hold higher loan balances on their books through the end of the year. The required minimum maturity for new PPP loans makes these loans less attractive for lenders to hold on their books following forgiveness. Lenders will also have to field requests to extend loans, although this should be mitigated by the fact that many more borrowers will receive full forgiveness and thus never need an extension.

Banks should expect to receive many questions on the new law in the days and weeks ahead and should develop a comprehensive plan for communicating these changes to their borrowers, both to ensure a consistent message and to minimize individual questions.

Forgiveness Extension

The original CARES Act provided that only qualifying costs during the first eight weeks following the loan, referred to as the covered period, were eligible to be forgiven. The bill extends the end of that covered period to the earlier of 24 weeks or December 31, 2020 for all new PPP loans. In addition, it allows existing borrowers to elect to choose whether to use the new 24-week covered period or the existing eight-week covered period. Existing borrowers may not choose any other covered period; they must choose either eight weeks or 24 weeks as their applicable covered period.

Existing PPP borrowers have substantial incentives to use the eight-week covered period if possible. For borrowers that are able to document eligible costs of 100% of the loan amount without any forgiveness cutback (whether due to the 60% payroll cost requirement, lower FTE count, or salary reductions), using the eight-week covered period should be the obvious choice because choosing the 24-week covered period means that the CARES Act restrictions apply throughout the 24-week covered period.

Once a borrower's covered period has ended, the borrower can run its business without having to consider the effect of any decisions on their ability to apply for forgiveness. For example, borrowers can right-size their staffs or certain compensation structures without the concern of impacting the level of PPP forgiveness available to them. While none of us wants to see headcount or pay reduced during this difficult time, generally having the freedom to manage one's business without restriction is valuable to managers and business owners.

This situation becomes all the more difficult for borrowers who do not need 24 weeks to achieve full forgiveness but need slightly more than eight. For example, it may be an appropriate business decision to forgo forgiveness of 10% of a loan in order to avoid an additional sixteen weeks of restrictions in addressing staffing levels. Borrowers should understand the implications of their choice of forgiveness period on the go-forward management of their businesses. Of course, under the bill, reductions in headcount are eligible for remediation if the employer eliminates the reduction not later than December 31, 2020 (as opposed to June 30, 2020 under the current version of the CARES Act).

While the extension from eight to 24 weeks should significantly increase the amount of forgiveness and should reduce the number of loans outstanding after forgiveness, it will also delay the time when banks are able to reduce PPP loan balances on their books through forgiveness. In addition, later forgiveness means later recognition of income from PPP fees for banks. To the extent that banks have forecasted recognition of that fee income in a given quarter, those forecasts may need to be revised.

Banks should ensure that borrowers are aware of the resources available to them in making a decision regarding the forgiveness period that is best for their business. Otherwise, inertia may result in borrowers choosing to delay the forgiveness application process, which may negatively impact the cost of the PPP loan to them.

Maturity of Five Years

The bill extends the maturity for all loans made **<u>after</u>** enactment of the bill to a minimum of five years and a maximum of ten years. This change is simple enough; lenders should ensure that loan documents for all loans made after the bill is enacted have a maturity of at least five years.

More interestingly, the bill also allows, but does not require, banks and borrowers to mutually agree to extend existing loans. While the original CARES Act, as modified by the April 2 Interim Final Rule, required a maturity of two years, borrowers with existing PPP loans may request that their lenders amend such loans to provide for maturity of five years.

While there seems to be little economic benefit to a bank of extending a 1% fixed rate, fully guaranteed loan by three years, some banks may be inclined to help borrowers who request such an extension. However, banks should consider the fair lending aspects of granting some, but not all, requests for extensions. In addition, depending on the facts and circumstances, Regulation B may require banks to send adverse action notices to borrowers who request an extension but are denied. The issue of whether a bank has or has not received an application triggering adverse action requirements can be complex. Accordingly, banks that decide to offer extensions may want to consider adopting formal policies and procedures to ensure that those extensions are offered in a fair and consistent basis, and in full compliance with all applicable laws and regulations. The economic considerations of an extension and the compliance burdens associated therewith may cause banks to adopt a policy that no extensions will be granted.

60%/40% Payroll Cost Limitation on Forgiveness

Although the CARES Act did not originally limit the percentage of forgivable costs that were required to be comprised of payroll costs, the April 2 Interim Final Rule imposed a requirement that no more than 25% of costs in a forgiveness application could be non-payroll costs. The bill amends the CARES Act to provide that a forgiveness application must include a minimum of 60% payroll costs and may include as much as 40% non-payroll costs. This change should increase the amount of forgiveness. While there is concern that the statutory language could result in no forgiveness being granted with respect to borrowers that had less than 60% of the loan amount spent on payroll costs during the covered period, we expect future clarification to relieve those concerns.

Forgiveness Cutbacks

The original CARES Act imposed a cutback of forgiveness for borrowers who reduced the number of FTEs employed during the covered period or who reduced salaries by more than 25% for employees earning less than $100,000 annually. Subsequent guidance made incremental changes, allowing borrowers to include in their FTE count employees terminated for cause or for whom an offer to rehire was made but refused. The bill broadens those exceptions, allowing borrowers to avoid a forgiveness cutback if they can document that they were unable either to rehire laid-off employees or to hire "similarly qualified" employees. The bill also allows borrowers to avoid forgiveness cutback if they can document an inability to return to previous levels of business activity due to the need to comply with HHS, CDC, OSHA requirements or guidance.

These changes, together with the extension of the covered period from eight to 24 weeks and the reduction of the payroll costs to 60%, should substantially increase the ability of the most affected businesses to obtain forgiveness.

Payment Deferral Period

The original CARES Act required an interest deferral of not less than six months nor more than one year, and the April 2 Interim Final Rule set this at six months. The bill now provides that the deferral period will end on the date that the lender receives forgiveness payment from SBA (or ten months from the end of the 24-week period for borrowers who do not apply for forgiveness).

For existing borrowers that apply for forgiveness based on the eight-week covered period, this change should have little practical effect. Such borrowers and lenders submitting timely forgiveness applications should receive payment in the Fall or sooner, consistent with the six and seven month deferrals reflected in the loan documents for loans made in April and May.

However, for new loans and existing loans where borrowers choose to use the 24-week covered period, this change will delay the first payments due into the first quarter of 2021. For existing loans, this change will also reduce the number of amortizing payments (unless loans are extended) and increase the amount of those payments.

From a practical standpoint, this change complicates the documentation of the loans: the first payment date in existing loan documents is no longer applicable, and the first payment date on future loans will be unknown at the time the loans are made. Banks should be sure to communicate this change to existing borrowers. This change will also require banks to send a communication to each borrower after the SBA remits forgiveness advising the borrower of the first payment date and the amortization schedule, although many banks likely expected to do this under the previous rules to communicate the required payment amounts following forgiveness.

What to Do Now

In addition to updating their form loan documents for new PPP loans, banks should review the loan documents they used to document their existing PPP loans to determine whether the documents should be amended and whether the bank has the unilateral authority to make such amendments. Many loan documents currently being used contemplate automatic amendments to comply with the CARES Act, which provisions should be helpful in addressing these changes.

The changes will also require amendments to the forgiveness application sent last month, and those amendments may include other changes based on the feedback to the original application.

The situation is little changed for existing borrowers who want to apply for forgiveness based on the eight-week covered period, which for many borrowers will end in the coming weeks. Given the benefits to borrowers of applying for forgiveness as soon as possible, banks may wish to inform borrowers that they may elect to do so.

Finally, banks should be prepared to respond to requests for loan extensions and should have a plan to communicate their policy.

Note: The summary above is based upon our preliminary understanding of H.R. 7010. The provisions of the bill are not yet effective. Interested parties should consult the resources published by Treasury and/or the SBA on a frequent basis to monitor new guidance that may materially alter how the provisions described above are applied to the Paycheck Protection Program.

For more information, contact the following attorneys.

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