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New scrutiny of PPP forgiveness seekers will come from their lenders – not SBA

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Sen. Susan Collins (R-Maine) speaks to reporters on Capitol Hill in Washington. The House on Thursday, May 28, overwhelmingly approved legislation that would relax the terms of a federal loan program intended to help small businesses weather the pandemic, giving companies more time and flexibility to use the money.

With billions and billions of dollars in potential income at stake, things are about to get serious between the lenders and Paycheck Protection Program (PPP) borrowers.

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Bankers and other lenders all across the country worked countless hours in the initial weeks to process the PPP applications of their clients, and receive approval from the U.S. Small Business Administration to complete those 1 percent, two-year-maturity loans. In return, lenders were promised as much as 5 percent in processing fees by the SBA for their services.

On May 22, however, the SBA made it clear to lenders that they have to go through a big step in order to qualify for those processing fees.

In recent weeks, some lenders already have sold their PPP portfolio in the secondary market because they did not want to get bogged down in trying to retrieve the money from the SBA as the PPP loans are 100 percent guaranteed by the federal agency.

But a guarantee can go only so far.

In the June 1 Federal Register, the U.S. Department of the Treasury makes it clear that if the SBA determines the borrower was ineligible for a PPP loan, the lender is not eligible for a processing fee.

"There's a general feeling that most documentation relating to forgiveness will not be correct, and PPP will become loans for small businesses," says Frank Williamson, CEO of Oaklyn Consulting, a Tennessee-based mergers and acquisitions firm. "The issue then becomes that these loans are likely not of good credit quality and servicing them could become a challenge."

In the initial days of the PPP, there was a mad dash among businesses and lenders alike to push the application and receive the money before the program ran out of money. The first tranche of $349 billion lasted less than two weeks. Large financial institutions such as Bank of America (NYSE: BAC), JPMorgan Chase (NYSE: JPM), Truist (NYSE: TFC), Wells Fargo (NYSE: WFC) and many others initially took care of their own customers and many other lenders, including community banks, welcomed new customers who were having trouble getting the bigger banks to process their loans.

That also means there could be hundreds of thousands of PPP loans out there, where loan lenders have very little information on the borrower. What makes the loan forgiveness process even more complex is that PPP administrators

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are now stating that they could commence a loan review months later – and when they do, the forgiveness process comes to a halt until the review is complete.

Nestled in the Federal Register document: If SBA has notified the lender that SBA has commenced a loan review, the lender shall not approve any application for loan forgiveness for such loan until SBA notifies the lender in writing that SBA has completed its review.

Customers shop through the window at a shoe store in Newark, N.J., on the first day that nonessential businesses were allowed to open, May 18, 2020. The House on Thursday, May 28, overwhelmingly approved legislation that would relax the terms of a federal loan program intended to help small businesses weather the pandemic, giving companies more time and flexibility to use the money.

Another major hurdle for small businesses that received the PPP loan would be the navigation of the loan-forgiveness process. Already, the SBA has laid down the terms for the lenders, stating banks, credit unions, online lenders and other financial institutions have 60 days after the expiration of the "expense covered period" to apply for forgiveness of the loans. The

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SBA, in return, could take as much as 90 days to accept, reject or send the forgiveness application back with questions.

But that's not all.

The SBA is instituting a clawback provision. If the SBA determines that a borrower was ineligible for a PPP loan based on the provisions of the CARES Act or application guidelines under the interim final rule (IFR), the SBA will seek repayment of the lender-processing fee from the lender, adding:

SBA's determination of the borrower eligibility will have no effect on SBA's guaranty of the loan if the lender has complied with its obligations under section III.3.b of the First Interim Final Rule and the document collection and retention requirements described in the lender application form.

Moreover, if the SBA asks the lender to return the processing fee, it may also determine the lender may not have properly collected, secured and retained the required documents needed to apply for forgiveness of the loans. In that case, the SBA "may determine that the loan is not eligible for a guaranty."

Mike Rozman, founder of BoeFly, a Boston-based company that helps PPP borrowers connect with lenders, says that the clawback provision is one of the most critical developments in recent days to the PPP forgiveness process.

"If the clawback provision is set in effect, lenders could lose the fee and will be required to hold the loan without a government guarantee," he says, adding "Without any collateral against that loan, they (the lenders) are now holding a 1 percent loan."

But Rozman argues that most lenders already have notified their borrowers that the loan forgiveness paperwork needs to be in order and the documents would be reviewed before sending them to the federal agency. "In that regard, I think the lenders and borrowers are on the same page," he says.

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If Congress decides to make changes to the PPP rules involving the forgiveness terms and how businesses can spend U.S. taxpayer money, lenders will have the PPP loan on their books for a much longer period of time. Williamson believes that's when the secondary market for PPP would become active.

"Banks are going to do their risk-management analysis and they would likely move on these PPP portfolios as soon as possible," he says.

More than 4.4 million businesses have received money under the PPP initiative. The program still has more than $120 billion left to distribute as the SBA and the Treasury continue to offer additional guidance for lenders and borrowers on a weekly basis regarding eligibility and forgiveness terms.

The U.S. House already has passed a bill that extends the spending period from eight weeks to 24 weeks, apportions only 60 percent of the PPP loan on payroll costs to qualify for forgiveness and retains the tax benefits tied to the non-forgivable part of the loan. U.S. Senator Marco Rubio, who chairs the Committee on Small Business and Entrepreneurship, has promised to take up the House bill, but also has indicated technical tweaks to the House version before sending it to President Donald Trump for passage.