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BRINGING SOME CERTAINTY TO UNCERTAIN PPP LOANS

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The pandemic has upended so many aspects of our lives this year, leaving many with uncertainty and worry. Congress extended a lifeline by passing the CARES Act to support both businesses and their employees with the Paycheck Protection Program (PPP) and has provided more relief with "second draw" PPP loans in a second stimulus bill. Through the PPP, small businesses received loans from the Small Business Administration (SBA) to cover payroll and other business expenses. The PPP loans would be forgiven if 60% of the funds were used to support ongoing payroll and companies met other qualifying criteria.

Congress acted quickly to pass the CARES Act, and businesses promptly responded to secure loans – even though the details surrounding the application process, rules governing the loans, and system for seeking forgiveness were vague, at best. Over five million companies received nearly $525 billion in the first round without fully knowing the applicable rules. Since this time, there have been over 25 interim final rules and many FAQs issued to clarify details, but there is still widespread confusion.

The SBA has six years to audit the PPP loan application as well as the application for, and the decree of, forgiveness. With so many borrowers, it's almost certain that the SBA will hire outside firms to assist with the auditing process. Initially, they will focus on outright and blatant fraud, but companies can expect their scrutiny to shift to whether applicants met the eligibility requirements for the loans and forgiveness. If problems are discovered in the application and forgiveness process, the business will need to fully repay the loan, plus interest. However, with so much uncertainty surrounding the original PPP loan process, how can any recipient be sure they have complied with all the rules?

There are two especially problematic aspects of the original PPP loans for companies:

- **Financial Necessity.** While the second draw loans have simplified the financial qualifying criteria by relying on loss of revenue, the original PPP loan process required certification that the borrower has a good faith belief that is the funds are necessary to support ongoing operations due to economic uncertainty after considering their ability to access other sources of liquidity without harming the business. In the frenzy to apply and receive funds, how did your company evaluate your financial necessity for the PPP loan? How widely and thoroughly did you investigate other sources of funds? If you haven't already, now is the time to document the process your company followed and to gather and organize all of the information you considered when evaluating your financial position, alternative financial resources, and the need for a PPP loan.

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- **Employee Threshold Eligibility.** The original PPP loans and forgiveness are intended for small businesses. This typically means companies with fewer than 500 employees (300 for second draw loans) but can include those that exceed this threshold if they meet the SBA definition of a "small business concern." On the surface, this seems straightforward, but it can quickly get complicated when the rules for SBA-defined affiliates are applied. How did your company determine its headcount? What analysis was performed of any SBA-defined affiliate companies? As noted previously, now is the time to document that process so you are prepared for a PPP loan/forgiveness audit.

If you still have concerns after you have documented the evaluation and decision-making processes that your company followed, you might want to explore an insurance policy for further protection. Concord Insurance and RT ExecPro have partnered to create a new and exclusive insurance product to address the ambiguity around these two aspects of PPP loans.

The policy has the following features:

- Coverage for loans up to $10 million
- Limits include the loan amount plus interest
- Deductible/retention of $200,000
- Coverage for each certification (financial necessity or employee threshold) or both
- Optional coverage for violation of the False Claims Act (FCA)
- Policy term extending up to six years - the duration of the SBA audit period
- Coverage is triggered by an adverse determination by the SBA, which can happen at the forgiveness stage or during the subsequent audit

While the SBA is initially focusing on PPP loans above $2 million, this insurance product is available for loans of any size.

Even with the best of intentions, PPP loan recipients will be vulnerable to these audits for the next six years. Acting now to document your actions and insure the funds received can help prevent another financial crisis for your business, should an audit become a reality. Do not hesitate to reach out to an experienced insurance broker like Parker, Smith & Feek for further advice.