

Insights

ADMINISTERING THE PAYCHECK PROTECTION PROGRAM AND MANAGING LITIGATION & REGULATORY RISK IN THE U.S.

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The Paycheck Protection Program (PPP) has seen extraordinary demand since the passage of the Coronavirus Aid, Relief, and Economic Security ("CARES") Act on March 27, 2020. Prior to the PPP going live just days later on April 3, banks and fin-tech companies scrambled to assemble teams and online application in-take and processing protocols to handle the onslaught of applications.

Over 1.6 million small businesses were approved for relief, a small fraction of the total number of small businesses in the U.S.

For many, the Program ground to a halt on April 16, 2020, a mere 13 days after it opened, when all of the \$349 billion in funding was exhausted. The abrupt and swift depletion of the Program left many small business owners in dismay and frustrated with their banks, and pondering what recourse they might have. A few quickly filed lawsuits. More lawsuits no doubt are coming.

As Congress gets set to appropriate more than \$300 billion in additional funding for the Program, and lenders prepare for ramping up their PPP operations for the second round of applications, it is smart to re-evaluate practices and consider some of the litigation risks that could arise.

Managing Risk with PPP Program and Preparing for Potential Litigation

In the face of a regulatory landscape without bright-line rules, it is important for lenders participating in the PPP to identify, manage, and minimize litigation risk. The regulatory and financial services litigators in our PPP Risk Management Team at Bryan Cave Leighton Paisner have identified several potential areas of risk that are worth serious attention.

- **Timeliness.** We have already seen one round of funding exhausted in a matter of days, even before many applicants could complete their applications. We are operating in an environment in which the speed of processing can make a difference in whether an applicant is funded. Indeed, seconds count. Many applicants who did not get funding are asking questions of their banks. Did you process my application in a timely manner? Was my application improperly delayed because my bank made a mistake evaluating the information I provided, which I believe was accurate and complete? Did other applicants jump ahead of me in line?

- **Prioritizing Loan Applications.** Although some have characterized the PPP as a government grant that is being administered by lenders, the federal fair lending laws apply. Thus, lenders need to consider how they can document their fair lending practices to minimize discrimination concerns. Lenders have had to process these loan applications under immense pressure and to a certain extent have had to manage applications through triage. Which applications do you handle first? How are banks addressing customers whose applications and backup materials are not easy to decipher? And what about existing customers vs. new customers? Such an environment often results in unintended consequences, which may spur unfair lending claims. Furthermore, when the second and any subsequent funding rounds go live, banks should consider how previously denied and/or pending applicants should be prioritized, if at all. Do they lose their place in line, or keep it? Under what circumstances?
- A number of lenders have wondered whether it is possible or permitted to perform underwriting in addition to that required by the SBA under the Program. While the SBA gave guidance that lenders could use their own form of note when it comes to closing the loan, and many local and regional SBA officials have informally stated that the SBA is prioritizing speed, it is not clear-cut whether additional underwriting requirements can be imposed. This situation is further complicated by the fact that certain members of Congress have urged lenders not to worry about underwriting because the loans are guaranteed by the government and their intention in writing the law was to smooth the process. If lenders decide to impose their own underwriting requirements, the rationale for those protocols should be carefully considered. If lender-imposed underwriting requirements create delays or application denials, applicants may challenge them.
- **False Claims Act (FCA).** The FCA allows the government or a private citizen to bring claims against people who knowingly, or with reckless disregard for the truth, submit false claims to the federal government. Penalties for violating the statute may include treble damages and involve potential company or individual criminal liability. Whistleblowers have an incentive to report alleged incidents or patterns of misconduct because they may recover a percentage of the damage award plus attorneys' fees if the claim is successful. Because PPP loan applications and borrowers' loan forgiveness applications involve government programs, they are subject to the FCA, Bank employees processing PPP loan applications may be incentivized to report alleged FCA violations. While lenders are "held harmless" in approving a borrower's loan forgiveness application, lenders should consider safeguards to prevent against clear fraud or inaccurate calculations.
- **Discriminatory impact.** As lenders work mightily to responsibly process as many loans as they can for their customers, they may face the possibility of accusations of discriminatory practices that violate Section 1983 of the Civil Rights Act (42 U.S.C. § 1983) or the Equal Credit Opportunity Act (15 U.S.C. § 1691) and Regulation B. Banks may want to evaluate their loan approval data through the first round of PPP funding, and make sure they are using the second

round of PPP funding to process loan applications for minority owned businesses and the unbanked. The latest round of PPP funding specifically sets aside funding for small businesses without banking relationships.

- **Post Hoc Criticism of Underwriting & Calculations.** While lenders are being told informally by SBA officials that they need to perform less underwriting and less examination of the applications than normally conducted for SBA loans, ultimately they are performing some degree of oversight in individual applications. Will the SBA or other agencies dig into the precise calculations of maximum loan amounts and loan forgiveness figures approved by lenders, and if so, how precise will those investigations be? Will the SBA change the rules down the road and hold lenders to higher underwriting standards notwithstanding current representations that the SBA is bearing the risk, not the lenders? While the answers to these questions may be uncertain at this time, what is certain is the need to consider the risks involved in whatever lender-driven steps may be taken.
- **Consumer Fraud Claims.** Although the PPP does not explicitly authorize any private cause of action, lenders may face state law based consumer fraud and UDAP claims alleging that lenders made misleading or false communications, or concealed material information, about their administration of the PPP program, including application or processing protocols. Such alleged fraud may be based on bank website content, statements issued by a bank, or communications between a bank and its applicant. In addition, some state statutes encompass unfair practices that do not require proving improper intent. Consumer fraud claims will likely be fact intensive and turn on an evaluation of policies and procedures as well as an evaluation of actual practices in approving loan applications.

Operations & Communications Impact Class Action & Regulatory Risk

Lenders are trying to do what is right and manage tremendous volumes under tight timeframes and changing circumstances. Understanding operational realities and proactively managing communications both within the institution and with customers will be critical to assessing and managing potential litigation or regulatory risk. Discretion in real time decisions by employees, and whether those decisions comply with or stray from policies and requirements, are likely to be scrutinized. Such activities may increase certain risks, on the one hand, but may be substantial factors in defending against litigation, including putative class actions, on the other hand. These variations may tend to narrow or limit the scope of any potential class or differentiate potential class members. The risks extend beyond litigation and certain established companies and their lenders may face reputational risk for participating in the PPP program if they are not typically perceived as a small business.

There is no one “right” answer and banks often face conflicting litigation risks with regard to their processing of PPP loans, but we believe having an understanding of these risks when implementing a PPP strategy will only help banks in defending against future litigation. As we wait for more

guidance from the U.S. government that will hopefully clarify a number of points, Bryan Cave Leighton Paisner can help lenders and borrowers navigate the regulatory minefield currently presented and can help mitigate risk.

RELATED PRACTICE AREAS

- Class Actions
- Business & Commercial Disputes
- Consumer Finance Disputes
- Financial Services Corporate & Regulatory Team

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