

# Insights: SBA Seeks to Quell Concerns over Lender Liability in the Paycheck Protection Program

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On March 27, 2020, President Trump signed into law the Coronavirus Aid, Relief, and Economic Security Act. The CARES Act created the \$349 billion Paycheck Protection Program (PPP), which is intended to provide partially forgivable loans to small businesses as an incentive to keep their workers on the payroll. Some lenders are reportedly concerned that, if they engage in the truncated underwriting required to disperse PPP funds expeditiously, they might later face liability under the False Claims Act or the Financial Institutions Reform, Recovery and Enforcement Act for loans processed based on inaccurate or fraudulent borrower information. In the PPP Interim Final Rule, promulgated on April 2, 2020, the Small Business Administration includes a number of provisions meant to assuage these fears and afford lenders some protection from liability. Nonetheless, lenders intending to participate in the PPP should proceed cautiously and monitor the rapidly changing landscape.

## Background

### Anti-fraud Statutes and the Financial Services Sector

The False Claims Act (FCA), 31 U.S.C. §§ 3729–3733, has long served as a principal method for combatting fraud in government programs, providing for significant penalties, treble damages, and private enforcement. The FCA can reach just about any claim for payment from the federal government, including those relating to financial services and lending activities. To prove a violation of the False Claim Act, the government, or a relator acting on the government’s behalf, must show that the defendant knowingly submitted a factually or legally false claim to the government and that the falsity was material to the government’s payment decision.<sup>1</sup>

The Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), 12 U.S.C. § 1833a, passed in the aftermath of the Savings and Loans scandals of the 1980s, permits the Department of Justice to pursue civil monetary penalties against entities or persons for violations of predicate criminal statutes that involve or affect financial institutions. The Financial Institutions Anti-Fraud Enforcement Act of 1990, 12 U.S.C. § 4205, permits whistleblowers to share in the government’s recoveries in FIRREA actions.

In the wake of the 2008 financial crisis, both the FCA and FIRREA formed the basis of numerous lawsuits and enforcement actions seeking damages from financial institutions for alleged failures in their underwriting processes.<sup>2</sup>

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<sup>1</sup> See *United States v. Corinthian Colls.*, 655 F.3d 984, 992, 996 (9th Cir. 2011).

<sup>2</sup> See, e.g., Press Release, Dep’t of Justice, Justice Department Recovers Nearly \$6 Billion from False Claims Act Cases in Fiscal Year 2014 (Nov. 20, 2014), <https://www.justice.gov/opa/pr/justice-department-recovers-nearly-6-billion-false-claims-act-cases-fiscal-year-2014> (“This brings recoveries for civil fraud and false claims against federal housing and mortgage programs from January 2009 through the end of fiscal year 2014 to \$4.65 billion.”); Press Release, Dep’t of Justice, Bank of America to Pay \$16.65 Billion in Historic Justice Department Settlement for Financial Fraud Leading up to and During the Financial Crisis (August 21, 2014), <https://www.justice.gov/opa/pr/bank-america-pay-1665-billion-historic-justice-department-settlement-financial-fraud-leading> (“the bank has agreed to pay a \$5 billion penalty under . . . FIRREA,” and the “Residential Mortgage-Backed Securities (RMBS) Working Group . . . has recovered \$36.65 billion to date”); see also Press Release, Dep’t of Justice, United States Files Lawsuit Alleging that Quicken Loans Improperly Originated and Underwrote Federal Housing Administration-Insured Mortgage Loans (April 23, 2015), <https://www.justice.gov/opa/pr/united-states-files-lawsuit-alleging>.

Additionally, the stimulus program passed in the wake of the 2008 financial crisis—the Troubled Assets Relief Program—led to additional fraud enforcement investigations and actions by the Special Inspector General for TARP. As of late 2019, SIGTARP investigations had led to 430 criminal charges, 24 enforcement actions against financial-services institutions, and \$11 billion in recoveries.<sup>3</sup>

The substantial liability incurred in these cases has made some financial institutions wary of participating in government-backed loan and stimulus programs. For example, according to FHA Commissioner Brian Montgomery: “Banks have said time and time again that the reason for their limited participation in FHA is the legal liability associated with enforcement actions stemming from the False Claims Act. They have expressed concern that even minor errors could expose them to severe penalties.”<sup>4</sup>

### The Paycheck Protection Program

In response to the Covid-19 pandemic, governments across the United States have mandated business shutdowns, which in turn have caused widespread economic devastation. In just the three weeks after the shutdowns were imposed, nearly 17 million Americans—or 11 percent of the U.S. labor force—filed for unemployment benefits, an economic shock not seen since the Great Depression.<sup>5</sup>

In an effort to stem the economic freefall, Congress passed the \$2 trillion CARES Act, which includes the \$349 billion Paycheck Protection Program. The PPP is a streamlined version of the Small Business Administration’s existing Section 7(a) loan program. Under the PPP, small businesses are eligible for loans of up to \$10 million through December 31, 2020. The Act provides a formula by which the loan amount is tied to payroll costs incurred by the business. The amount of the loan that is equal to eight weeks of payroll support (including employee salaries, paid sick or medical leave, insurance premiums, mortgage interest, rent, and utility payments) is forgivable upon the borrower filing with the lender documentation of those costs. Borrowers must make “good-faith” certifications that: the loan is necessary due to the uncertainty of current economic conditions caused by COVID-19; they will use the funds to retain workers and maintain payroll, mortgage, lease, and utility payments; they do not already have a pending application for a loan under the PPP; and they are not receiving duplicate funds from another SBA program. The CARES Act authorizes the preexisting network of SBA-approved lenders to offer the PPP loans, and the SBA has further authorized as lenders, among others, all federally insured depository institutions and all federally insured credit unions.

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[quicken-loans-improperly-originated-and-underwrote](#); Press Release, Dep’t of Justice, Federal Government and State Attorneys General Reach Nearly \$1 Billion Agreement with SunTrust to Address Mortgage Loan Origination as Well as Servicing and Foreclosure Abuses (June 17, 2014), <https://www.justice.gov/opa/pr/federal-government-and-state-attorneys-general-reach-nearly-1-billion-agreement-suntrust>.

<sup>3</sup> See U.S. Dep’t of Treasury, Office of the Special Inspector Gen. for the Troubled Assets Relief Program, Semiannual Report to Congress 5–6 (Oct. 30, 2019), [https://www.sig tarp.gov/Quarterly%20Reports/October\\_30\\_2019\\_Report\\_to\\_Congress.pdf](https://www.sig tarp.gov/Quarterly%20Reports/October_30_2019_Report_to_Congress.pdf).

<sup>4</sup> Jessica Guerin, *FHA Clarifies Rules to Attract More Participants to its Mortgage Lending Program*, HOUSING WIRE (May 9, 2019), <https://www.housingwire.com/articles/49011-fha-clarifies-rules-to-attract-more-participants-to-its-mortgage-lending-program/>; see also Ben Eisen, *Banks Fled the FHA Loan Program. The Government Wants Them Back*, WALL STREET JOURNAL (May 9, 2019), <https://www.wsj.com/articles/banks-fled-the-fha-loan-program-the-government-wants-them-back-11557417600>.

<sup>5</sup> See Quint Forgey & Rebecca Rainey, *Unemployment Claims Near 17 Million in Three Weeks as Coronavirus Ravages Economy*, POLITICO (April 9, 2020), <https://www.politico.com/news/2020/04/09/coronavirus-unemployment-claims-numbers-176794>.

Treasury Secretary Steven Mnuchin has said that, given the severity of the current economic crisis, the administration is focused on getting PPP loans distributed quickly.<sup>6</sup> As of April 10, the SBA had reported that 600,000 loans totaling \$161 billion have been approved, and Congress is now considering adding another \$250 billion to the program.<sup>7</sup>

### Uncertainty for Lenders

For small businesses throughout the country, the PPP may prove to be a vital lifeline. But the incredible sums of money available in the program, the speed with which desperate borrowers will be preparing applications, and the truncated underwriting lenders will need to perform to quickly effectuate the PPP, raise the specter of inaccurate or fraudulent borrower applications. And simultaneous with its commitment to pumping out economic stimulus, the federal government has signaled that it will aggressively pursue fraud related to COVID-19. For example, on March 16, 2020, Attorney General Barr directed “[e]very U.S. Attorney’s Office . . . to prioritize the detection, investigation, and prosecution of all criminal conduct related to the current pandemic.”<sup>8</sup> And on March 31, 2020, the government indicated in an “Information Sheet” that lenders in the PPP would be responsible for “verify[ing]” that borrowers actually meet eligibility requirements.<sup>9</sup>

The confluence of the government’s focus on speed and its demand for accuracy created a situation in which many lenders were unwilling to engage in the PPP. On April 1, 2020, the Independent Community Bankers of America wrote to the Treasury and SBA regarding a number of concerns, including “lender liability,” concluding that “many banks have already indicated that they will not be able to use the Program under the current terms” and that others “will only use it for current customers.”<sup>10</sup> This letter was followed by media reports that many lenders were indeed only accepting PPP applications from individuals with whom they had a prior lending relationship.<sup>11</sup>

### The SBA’s PPP Interim Final Rule, FAQ Guidance Document, and Lender Application Form

On April 2, 2020, the SBA released the Paycheck Protection Program Interim Final Rule.<sup>12</sup> The IFR includes several provisions that appear calculated to assuage lenders’ concerns about liability for inaccurate borrower representations and truncated underwriting.

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<sup>6</sup> Craig Torres, *Mnuchin Says Small Business Loans Up and Running This Week*, BLOOMBERG (March 29, 2020),

<https://www.bloomberg.com/news/articles/2020-03-29/mnuchin-says-small-business-loans-to-be-up-and-running-this-week>

<sup>7</sup> Jeanne Whalen & Renae Merle, *Small Businesses are Still Awaiting Emergency Loans — and Facing a Dilemma About how to Spend Them*, WASHINGTON POST (April 10, 2020), <https://www.washingtonpost.com/business/2020/04/10/small-businesses-are-still-awaiting-emergency-loans-facing-dilemma-about-how-spend-them/>.

<sup>8</sup> Memorandum from William Barr to all United States Attorneys (March 16, 2020),

<https://www.justice.gov/ag/page/file/1258676/download>.

<sup>9</sup> U.S. Dep’t of the Treasury, Paycheck Protection Program (PPP) Information Sheet (March 31, 2020),

<https://home.treasury.gov/system/files/136/PPP%20Lender%20Information%20Fact%20Sheet.pdf>.

<sup>10</sup> U.S. Dep’t of the Treasury, Paycheck Protection Program (PPP) Information Sheet (March 31, 2020),

<https://home.treasury.gov/system/files/136/PPP%20Lender%20Information%20Fact%20Sheet.pdf>.

<sup>11</sup> See, e.g., Peter Rudegeair & Ruth Simon, *Big Banks Favor Certain Customers in \$350 Billion Small-Business Loan Program*, THE WALL STREET JOURNAL (April 6, 2020), <https://www.wsj.com/articles/big-banks-favor-certain-customers-in-350-billion-small-business-loan-program-11586174401>.

<sup>12</sup> Small Business Administration, Interim Final Rule, 13 CFR pt. 120, Bus. Loan Program Temporary Changes, Payment Prot. Program, RIN 3245-AH34 (2020) (hereinafter “IFR”), available at [https://www.sba.gov/sites/default/files/2020-04/PPP--IFRN%20FINAL\\_0.pdf](https://www.sba.gov/sites/default/files/2020-04/PPP--IFRN%20FINAL_0.pdf).

First, the IFR includes general assurances that lenders may rely on borrower certifications (Reliance Clauses) and that the SBA will hold lenders harmless for doing so (Hold Harmless Clauses). Specifically, the Reliance Clauses state that “SBA will allow lenders to rely on certifications of the borrower in order to determine eligibility of the borrower and use of loan proceeds and to rely on specified documents provided by the borrower to determine qualifying loan amount and eligibility for loan forgiveness.”<sup>13</sup> The Hold Harmless Clauses state that lenders “must comply with the applicable lender obligations set forth in this interim final rule, but will be held harmless for borrowers’ failure to comply with program criteria,” and that the SBA “will hold harmless any lender that relies on . . . borrower documents and attestation from a borrower” for loan forgiveness.<sup>14</sup>

Second, with respect to origination, the IFR specifically limits “each lender’s underwriting obligation” to “reviewing the ‘Paycheck Protection Application Form’”; “confirm[ing] receipt of information demonstrating that a borrower had employees for whom the borrower paid salaries and payroll taxes on or around February 15, 2020”; “confirm[ing] the dollar amount of average monthly payroll costs for the preceding calendar year by reviewing the payroll documentation submitted with the borrower’s application”; and following applicable Bank Secrecy Act requirements.<sup>15</sup>

In a follow-on “Frequently Asked Questions” guidance document, which the SBA states “lenders may rely on,” the SBA specifically addresses a lender’s obligation to “[c]onfirm the dollar amount of average monthly payroll costs” and states that the lender need not “replicate every borrower’s calculations.”<sup>16</sup> Instead, “providing an accurate calculation of payroll costs is the borrower’s responsibility” and lenders need only perform a “good faith review, in a reasonable time, of the borrower’s calculations and supporting documents.” As an example, the guidance states that “minimal review of calculations based on a payroll report by a recognized third-party payroll processor would be reasonable.”

Third, with respect to loan forgiveness, the IFR states that a lender “does not need to conduct any verification if the borrower submits documentation supporting its request for loan forgiveness and attests that it has accurately verified the payments for eligible costs.”<sup>17</sup>

In addition to the IFR and FAQ guidance document, the SBA has also released the PPP Lender Application Form.<sup>18</sup> Significantly, the form requires only limited certifications by the lender:

- “The Lender has complied with the applicable lender obligations set forth in paragraphs 3.b(i)-(iii) of the Paycheck Protection Program Rule.”
- “The Lender has obtained and reviewed the required application (including documents demonstrating qualifying payroll amounts) of the Applicant and will retain copies of such documents in the Applicant’s loan file.”

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<sup>13</sup> IFR § III.1. *See also id.* § III.3(c) (lenders can “rely on borrower documentation for loan forgiveness”); III.4(a)(v) (“lenders will be permitted to rely on certifications of the borrower in order to determine eligibility of the borrower and the use of loan proceeds”).

<sup>14</sup> IFR §§ III.1, III.3.c.

<sup>15</sup> IFR § III.3.b.

<sup>16</sup> Small Business Administration, Paycheck Protection Program Loans Frequently Asked Questions (FAQs) (April 13, 2020), available at <https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequently-Asked-Questions.pdf>.

<sup>17</sup> IFR § III.3.c.

<sup>18</sup> SBA Form 2484, Paycheck Protection Program Lender Application Form - Paycheck Protection Program Loan Guaranty, available at [https://www.sba.gov/sites/default/files/2020-04/PPP%20Lender%20Application%20Form\\_0.pdf](https://www.sba.gov/sites/default/files/2020-04/PPP%20Lender%20Application%20Form_0.pdf).

- “Neither the undersigned Authorized Lender Official, nor such individual’s spouse or children, has a financial interest in the Applicant.”

### Considerations for PPP Lenders

The last few weeks have produced a flurry of activity: Congress’s overnight creation of a new \$349 billion loan program; the administration’s issuance of an Information Sheet that nearly froze lending activity within that program; the SBA’s issuance of an IFR and Lender Application Form that depart from the earlier Information Sheet’s guidance and in an apparent effort to better insulate lenders; and a subsequent guidance document explicitly stating that lenders may rely upon it.

What should lenders take from all this?

#### Protections from Potential Fraud Liability

On the one hand, it is clear that the federal government is attempting to limit potential lender liability to encourage expedited lending. As matters now stand, the IFR provides to lenders significantly more protection from underwriting liability than does the SBA’s traditional 7(a) loan program. The 7(a) program requires lenders to certify that information provided by a borrower “is true and correct, to the best of [the lender’s] knowledge” and that the lender has “exercised due diligence to obtain true and correct information” from the borrower.<sup>19</sup> The PPP IFR significantly relaxes these certifications by requiring lenders only to attest that the lender has “obtained and reviewed the required application” and complied with a portion of the IFR, which specifically permits lenders to rely on a borrower’s representations, as opposed to engaging in rigorous due diligence to confirm the accuracy of those representations.

Moreover, the IFR’s Reliance Clauses are important because they could serve to negate the scienter and falsity prongs of both the FCA and the FIRREA predicates. Similarly, the IFR’s Hold Harmless Clauses are important because they could negate the FCA’s materiality prong: a lender’s submission to the government of a borrower’s information, without verification of the accuracy of that information, should not be seen as material to the government’s payment decision if the government explicitly stated it would hold the lender harmless for any falsity in that information.

Finally, the limited lender certifications required in the Lender Application Form could substantially limit potential False Claims Act liability, especially on implied certification theories that rely on general compliance with otherwise applicable laws and regulations.<sup>20</sup> For example, the Lender Application Form requires certification of compliance with “the applicable lender obligations set forth in paragraphs 3.b(i)-(iii)” of the IFR, but the requirement to comply with the Bank Secrecy Act is found only in subsection 3.b(iv). Accordingly, although some have already speculated that PPP FCA liability could be premised on faulty BSA procedures, a lender would have a potent argument that the SBA specifically omitted any requirement that lenders certify BSA compliance, and thus no false certification was submitted for payment purposes.

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<sup>19</sup> See Small Business Administration Form 2020, available at <https://www.sba.gov/sites/default/files/2017-10/Form%201920%20Fillable.pdf>.

<sup>20</sup> See *Universal Health Servs., Inc. v. United States ex rel. Escobar*, 136 S. Ct. 1989, 2001 (2016) (“the implied certification theory can be a basis for liability”).

## Cautions and Unknowns

On the other hand, PPP lenders should still proceed carefully with this new program.

First, the statute, IFR, lender application, and guidance document have all been written at break-neck speed, and some rules have seemingly flipped overnight (compare the Treasury Department's original Information Sheet's guidance on underwriting with the IFR's). Accordingly, lenders should pay close attention to any changes to the rules, guidance documents, or forms that government agencies promulgate with respect to the PPP. Materiality is a key element of FCA liability and these pronouncements may ultimately determine which considerations are material to the government's payment decisions.<sup>21</sup>

Second, lenders should keep in mind that the IFR still requires some basic due diligence. If a borrower's calculations of average monthly payroll amounts are facially erroneous upon even minimal review, a lender would not be shielded from liability for relying on such calculations. Accordingly, even though the PPP is designed to encourage a quick turn on lending, lenders should not ignore obvious errors in borrower materials.

Third, as the financial-services community well knows, the Department of Justice and the private bar have a record of creativity in devising theories of FCA and FIRREA liability. If the fast-approaching 2020 election brings a new administration, the officials who wrote the current rules will likely depart and new officials at the SBA or Department of Justice could have different views on FCA and FIRREA enforcement. Thus, it is not possible to say that any regulatory action can eliminate all potential liability. While the IFR provides about as good of an argument as one could hope for against underwriting liability, a non-zero risk level remains, absent additional congressional action.

Fourth, whatever protections the IFR provides apply only to straightforward underwriting and origination activity under the PPP. Downstream activity, such as securitization and sale of PPP loans, could lead to liability for misrepresentations regarding the quality or underwriting of the loan pool. Thus, lenders should be careful to rely only on the protections explicitly stated in the IFR and not assume it protects other activity related to PPP loans.

Finally, even though the lack of certification of compliance with Bank Secrecy Act requirements provides a potent argument against FCA liability for faulty BSA procedures, the BSA itself imposes substantial criminal and civil penalties for noncompliance by financial institutions.<sup>22</sup> Thus, because the PPP requires lender compliance with the BSA, lenders in the program should be careful to ensure they are meeting those regulatory requirements.

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<sup>21</sup> See Escobar, 136 S. Ct. at 1996.

<sup>22</sup> See 31 U.S.C. §§ 5321, 5322.