

WHY SEC-REGULATED FIRMS MAY NOT YET BE OUT OF THE WOODS ON PAYCHECK PROTECTION PROGRAM-RELATED ENFORCEMENT

On May 13, 2020, the U.S. Small Business Administration (the “SBA”) and the U.S. Department of the Treasury (together with the SBA, the “Agencies”) released additional guidance¹ relating to the Paycheck Protection Program (“PPP”), the small business loan program originally authorized by Title I of the CARES Act.² This long-awaited guidance addresses the SBA's plans to review the certification required of PPP recipients that “[c]urrent economic uncertainty makes this loan request necessary to support the ongoing operations of the Applicant” (the “Necessity Certification”). Specifically, the SBA advised that it will presume PPP recipients who received a loan of less than \$2 million to have made the Necessity Certification in good faith, but that the SBA will review loans of \$2 million or more³ to determine whether there was an “adequate basis” for the Necessity Certification. A recipient that pays back the loan, regardless of whether such recipient had an “adequate basis” for the original request, will not be subject to SBA enforcement or referral to another agency. Notwithstanding this assurance, we believe the U.S. Securities and Exchange Commission (the “SEC”) may independently examine firms subject to its jurisdiction that received PPP loans to ensure that such firms made proper disclosures to shareholders, investors and

Key issues

- While the SBA has stated that it will presume that PPP loan recipients who received less than \$2 million have made the Necessity Certification in good faith, and that recipients of loans of \$2 million or more will not be subject to SBA enforcement action if the loan is paid back in full, any SEC-regulated firm that has received a loan must consider their relevant obligations to investors and clients from an SEC perspective.
- The SEC has already taken an interest in regulated entities who received a PPP loan. Publicly traded companies and registered investment advisers should evaluate their disclosures to investors and clients in light of the purposes of the PPP.

¹ See U.S. Small Business Administration, Paycheck Protection Program Loans – Frequently Asked Questions (FAQs), (last modified May 13, 2020), available at https://www.sba.gov/sites/default/files/2020-05/Paycheck-Protection-Program-Frequently-Asked-Questions_05%2013%2020_2.pdf (the “FAQs”).

² The initial \$349 billion authorized for the PPP under the CARES Act was exhausted approximately two weeks after the program's launch. The Paycheck Protection Program and Health Care Enhancement Act, signed into law on April 24, 2020, provided an additional \$310 billion for the program. As of the date of this writing, PPP funds remain available.

³ The guidance addresses the treatment of PPP loans “less than \$2 million” and “in excess of \$2 million” but does not address a PPP loan equal to \$2 million. We believe that recipients of a PPP loan equal to \$2 million should assume, in the absence of further guidance, that they will be treated as if subject to SBA review.

clients relating to their need for the loans. This briefing discusses disclosure considerations for publicly traded companies and registered investment advisers (“RIAs”).

THE “NECESSITY CERTIFICATION”

Under the CARES Act, a PPP loan recipient is required to certify in good faith that “the uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations of the eligible recipient.”⁴ While the CARES Act included a presumption in favor of a PPP applicant’s need for the loan, there was significant uncertainty surrounding the level of economic impact required to support that the Necessity Certification was indeed made in good faith.

It was not until April 23, 2020, nearly one month after the CARES Act was signed into law, that the Agencies provided additional guidance relating to the Necessity Certification. Specifically, the Agencies advised that applicants, prior to applying for a PPP loan, must “take into account their current business activity and their ability to access other sources of liquidity sufficient to support their ongoing operations in a manner that is not significantly detrimental to the business.” To that end, the Agencies commented that *publicly traded* companies with (i) substantial market value and (ii) access to capital markets would likely be unable to make the Necessity Certification in good faith.⁵ On April 28, the Agencies indicated this guidance was also applicable to *private* companies with “adequate” sources of liquidity.⁶

As PPP loan recipients continued to evaluate whether the Agencies would consider the Necessity Certification to have been made in good faith, further guidance was published on May 13 providing that any borrower that, together with its affiliates,⁷ received a PPP loan with an original principal amount of less than \$2 million would be presumed to have made the Necessity Certification in good faith. Borrowers who received loans of \$2 million or more would be subject to SBA review to determine whether there was an “adequate basis” for the Necessity Certification. Where the SBA determines that the recipient lacked an “adequate basis,” it will direct the recipient to pay back the loan, and will “not pursue administrative enforcement or referrals to other agencies” if the outstanding loan balance is repaid.

CONSIDERATIONS FOR SEC-REGULATED PPP LOAN RECIPIENTS

Although PPP loan recipients who either received a loan under \$2 million or who pay back a loan of \$2 million or more may appear to be free from additional federal scrutiny, firms under SEC jurisdiction are likely to be subject to ongoing interest around the receipt and disclosure of PPP loans and the firm’s related financial condition.

⁴ Section 7(a)(36)(G)(I)(ii) of the Small Business Act (15 U.S.C. 636(a)(36)(G)(I)(ii), as added by Section 1102 of the CARES Act.

⁵ See the FAQs, Question 31.

⁶ See the FAQs, Question 37.

⁷ See SBA Interim Final Rule on Affiliates, 85 FR 20817 (Apr. 15, 2020), available at <https://home.treasury.gov/system/files/136/SBA%20IFR%202.pdf>.

Publicly traded companies

Publicly traded companies continue to be a significant focus of media attention relating to the PPP program. While there have been notable instances of publicly traded companies returning a PPP loan,⁸ over 400 publicly traded companies have disclosed receipt of PPP loans in 8-K filings, for a total of over \$1.3 billion, while only 65 publicly traded companies have returned the PPP loans.⁹ We believe the SEC will closely scrutinize whether there was an “adequate basis” for making the Necessity Certification.

Publicly traded companies that received PPP loans must consider the appropriateness of their financial disclosures to shareholders and potential investors. Given the importance of the Necessity Certification, the receipt of a PPP loan could be viewed by a reasonable investor as an acknowledgement that a company’s financial condition is precarious. A PPP recipient should contemplate, in light of its existing disclosure, whether the disclosure of its receipt of a PPP loan could lead investors to conclude that previous disclosure, which did not suggest that the recipient was in financial distress, contained a material omission about the financial condition of the company. Additionally, a publicly traded company that disclosed receipt of a PPP loan and then later paid back the loan should consider whether the initial disclosure could be construed as misleading in light of the circumstances around the decision to apply for the PPP loan and the subsequent decision to repay the loan (rather than seek loan forgiveness). An issuer should consider any public statements relating to PPP loans carefully, to ensure that the issuer is not perceived as making contradictory statements regarding its financial condition.

Investment Advisers

RIAs that received PPP loans should also anticipate interest from the SEC as to the appropriateness of receipt and disclosure of the loan and the adviser’s related financial condition. Thus far, 116 RIAs have disclosed receipt of a PPP loan in their Form ADVs.

The staff of the SEC’s Division of Investment Management (the “**Staff**”) has advised that an RIA must, pursuant to its fiduciary duty, make “full and fair disclosure” to clients of all “material” facts relating to the advisory relationship, which would likely include the receipt of a PPP loan.¹⁰ Specifically, the Staff has taken the view that RIAs receiving a PPP loan should disclose the “nature, amounts, and effects” of such financial assistance. According to the Staff, such RIAs should, for example, disclose whether the PPP loan was necessary to pay the salaries of employees that provide advisory functions for clients. Additionally, such RIAs should consider whether circumstances that led the RIA to apply for a PPP loan necessitate any disclosures under Item 18 of Part 2 of Form ADV, which requires investment advisers that have discretionary authority or custody of client funds or securities, or which require or solicit prepayment of more than \$1,200 in fees per client, six months or more in advance, to disclose of “any financial condition that is reasonably

⁸ See, e.g., “Shake Shack Returns \$10 Million Emergency Loan to the US Government,” CNN, <https://www.cnn.com/2020/04/20/business/shake-shack-ppp-loan-sba/index.html> (Apr. 20, 2020).

⁹ Data from FactSquared, <https://factba.se/sba-loans> (accessed May 18, 2020).

¹⁰ See U.S. Securities and Exchange Commission, Division of Investment Management Coronavirus (COVID-19) Response FAQs, (last modified May 8, 2020), available at <https://www.sec.gov/investment/covid-19-response-faq>.

likely to impair [their] ability to meet contractual commitments to clients.” Such RIAs should further be prepared to address the receipt of a PPP loan in the course of any upcoming SEC examinations.

Furthermore, RIAs should consider the following:

- Whether side letters with clients would require the disclosure of the receipt of a PPP loan.
- Whether existing credit facilities would necessitate consent from lenders prior to applying for a PPP loan.
- Performing due diligence with potential clients and consultants and considering the accompanying reputational effects of receiving a PPP loan.
- If advising private equity and hedge funds, whether the RIA would be ineligible for a PPP loan in light of the SBA's Interim Final Rule issued on April 24, 2020, which provided that "hedge funds and private equity firms" were ineligible for the PPP.¹¹

¹¹ See SBA Interim Final Rule on Requirements for Promissory Notes, Authorizations, Affiliation, and Eligibility, 85 FR 23450 (Apr. 28, 2020), available at <https://home.treasury.gov/system/files/136/Interim-Final-Rule-on-Requirements-for-Promissory-Notes-Authorizations-Affiliation-and-Eligibility.pdf>.

CONTACTS

Jeff Berman
Partner

T +1 212 878 3460
E jeffrey.berman
@cliffordchance.com

Cliff Cone
Partner

T +1 212 878 3180
E clifford.cone
@cliffordchance.com

Jefferey LeMaster
Partner

T +1 212 878 3206
E jefferey.lemaster
@cliffordchance.com

Celeste Koeleveld
Partner

T +1 212 878 3051
E celeste.koeleveld
@cliffordchance.com

Kathleen Werner
Partner

T +1 212 878 8526
E kathleen.werner
@cliffordchance.com

Andrew Nelson
Associate

T +1 212 878 8284
E andrew.nelson
@cliffordchance.com

Matthew Press
Associate

T +1 212 878 8521
E matthew.press
@cliffordchance.com

Eric Bernstein
Associate

T +1 212 878 3411
E eric.bernstein
@cliffordchance.com

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

www.cliffordchance.com

Clifford Chance, 31 West 52nd Street, New York, NY 10019-6131, USA

© Clifford Chance 2020

Clifford Chance US LLP

Abu Dhabi • Amsterdam • Barcelona • Beijing • Brussels • Bucharest • Casablanca • Dubai • Düsseldorf • Frankfurt • Hong Kong • Istanbul • London • Luxembourg • Madrid • Milan • Moscow • Munich • Newcastle • New York • Paris • Perth • Prague • Rome • São Paulo • Seoul • Shanghai • Singapore • Sydney • Tokyo • Warsaw • Washington, D.C.

Clifford Chance has a co-operation agreement with Abuhimed Alsheikh Alhagbani Law Firm in Riyadh.

Clifford Chance has a best friends relationship with Redcliffe Partners in Ukraine.