



AMERICAN **BAR** ASSOCIATION

Criminal Justice Section

Criminal Justice Section Newsletter

Navigating CARES Act: Legal, Compliance and Operational Risks

By Paul Peterson and Marcantonio Barnes

As borrowers and financial institutions advance further down the CARES Act loan program cycle, they should be aware of and prepare for impacts to the business as a result of legal and compliance risks from these programs. These risks are perhaps even more pronounced for entities that have not previously participated in either SBA or Treasury-sponsored loan program.

Throughout the CARES Act loan cycle, it is essential that these legal and compliance requirements are carefully considered and adhered to in order to help reduce operational risks to the business for both borrowers and lenders. These risks include denial of guarantees for lenders, rejection of forgiveness applications for borrowers, as well as litigation and sanctions from various state and federal oversight and enforcement authorities.

Strategy, Risk Advisory, and Application Concerns

As part of the CARES Act, the federal government required borrowers and lenders to make and adhere to certifications and statements made during loan origination, as well the complex web of interim and final rules, FAQs and developing case law on program administration and compliance. While the federal government has made significant progress in developing guidance for each of the many CARES Act loan programs, both borrowers and lenders face substantial risks in the coming months as they work to navigate both established and developing precedent for loan administration and compliance.

For example, as part of a broader effort to ensure program integrity, the federal government is requiring Paycheck Protection Program (PPP) loan recipients who are seeking loan forgiveness to submit documentation detailing how the PPP funds were spent. Businesses that received PPP loans in excess of \$2 million will be subject to an increased level of scrutiny. More recently, the borrowers began receiving an SBA questionnaire that likely serves as a first step in their oversight evaluation process. The potential financial and operational risk of these events on forgiveness applications, loan guarantees and other parts of the CARES Act loan cycle cannot be understated.

For many entities, the CARES Act introduces compliance and regulatory considerations that were either not present or, if

they existed, presented minimal or unknown risks to the business. Compliance and regulatory experts and resources can help evaluate, synthesize and manage the financial, legal and operational risks to the business resulting from a decision by either a borrower or lender to participate in one or more CARES Act loan programs. This applies to either making certifications to a CARES Act loan program or to borrower and lender due diligence processes and control environments throughout the loan cycle, including loan forgiveness applications and other post-closing loan administration requirements such as obtaining federal guarantees for each of these loans.

The guidelines and processes of Federal guarantees for PPP loans are still being developed. This delay in publishing these guidelines is creating an added level of concern amongst lenders. PPP compliance to reach the full guarantee status will be a top priority as lenders continue to work through post-closing loan activities. While we are not at the default stage yet, we are getting closer and PPP borrowers and lenders should prepare for enhanced scrutiny as the federal government starts processing PPP loan guarantees.

Litigation Concerns

The CARES Act establishes formal oversight through three regulatory bodies: (1) the Special Inspector General for Pandemic Recovery within the Department of the Treasury (DoT), (2) the Pandemic Response Accountability Committee, and (3) a Congressional Oversight Committee. Borrowers and lenders can also expect to see oversight from the Department of Justice (DOJ) as well as other regulatory bodies, such as the Security and Exchange Commissions' Division of Enforcement and the Office of the Attorney General of the SBA. Oversight will be focused on enforcing compliance with the various CARES Act programs, with a focus on fraud.

For example, the SBA has established, in some cases, unique administrative processes for appealing SBA loan review decisions, including decisions regarding borrower eligibility for a loan, a particular loan amount, or forgiveness in the amount determined by the lender. CARES Act loans potentially involve both administrative and judicial review issues that need to be carefully considered by both borrowers and lenders. The processes and procedures for appealing denials or other agency actions, such as questionnaires, require careful thought, experience and planning.

Administrative/Regulatory Audits and Investigations

From the inception of the CARES Act, the Justice Department and other government officials have communicated an intent to inquire into how CARES Act loan program funds, including PPP, are/were disbursed. The SBA has stated that it plans to audit all loans in excess of \$2 million and will audit a sample

Paul Peterson is a partner in BDO USA, LLP Forensic Practice. Marcantonio Barnes is a partner at Barnes & Thornburg, LLP.

of smaller loans. As previously mentioned, SBA issued its PPP Loan Necessity Questionnaire. While appearing to be a perfunctory administrative exercise, these and other similar communications present larger audit and investigation risks that should be carefully evaluated by both borrowers and lenders.

The SEC's Division of Enforcement has been focusing efforts on registered investment advisors and issuers that have received PPP funds. The SEC is scrutinizing the recipients' need and eligibility for federal assistance and representations made in loan applications. In addition, they are scrutinizing whether there are inconsistencies with public statements and disclosures prior to and after the receipt of PPP funds. Similar to the SBA, the SEC is also interested in and evaluating how companies are using PPP funds. We expect that the SEC will continue to actively focus resources to investigate and bring charges against companies and executives in carrying out its mission to protect the interests of investors.

In addition to government scrutiny being applied to PPP fund recipients, the SBA OIG's office will be assessing inappropriate lender activity and schemes as federal guarantees for PPP loans are processed. As borrower schemes continue to be unveiled on a daily-basis, the SBA's oversight body and other Federal CARES Act regulatory bodies will look closely at the level of care taken by lenders as these loans were being processed. If patterns are revealed identifying certain lenders having more "fraudulent" PPP loans than others, inquiries will likely follow that evaluate the practices of those lenders with greater scrutiny. These borrower schemes will come in all forms and may show lender culpability and involvement. A best practice at this stage would be for lenders to re-evaluate their PPP loan processing activities to understand risks and establish defensible positions.

Compliance/Risk Management Controls

It is essential for borrowers and lenders to understand and develop effective compliance programs and other proactive measures that test, evaluate and prepare the business for and against CARES Act audit and investigative inquiries by administrative and regulatory authorities.

These proactive measures should be applied whether or not the PPP borrower is seeking loan forgiveness. We understand that the SBA will apply the same level of monitoring and oversight regardless if loan forgiveness is requested. Those companies choosing to forego loan forgiveness do not get a free pass and will still have to be prepared to demonstrate that guidelines were properly followed and borrower documents submitted during the PPP application process are accurate.

A measured, proactive approach is key to stay compliant with the many requirements of the various CARES Act facilities and stabilization programs. This approach includes managing the company's compliance and financial controls of these programs, implementing best practices, and reducing the risks

of noncompliance associated with these relief funds. Overall, the costs involved in implementing a robust, proactive CARES Act compliance program and controls are less than a strategy of reacting unprepared to a government inquiry.

The PPP, Mainstreet loan programs, Payroll Support Program all have strict post-disbursement rules. These requirements cover areas such as use of funds, employee retention requirements, certifications, company compensation restrictions and financial reporting obligations. Important steps that should be considered include:

- Evaluating controls/processes, policies, and best practices such as rigorous board and management oversight and designating a CARES compliance officer or point person for all related matters to help maintain program compliance
- Working with company management to evaluate and remediate, if gaps are identified, the current control environment to meet contractual/compliance requirements
- Updating company management with risk management tactics, such as process improvement and control enhancement or design and monitor, evaluate and ensure compliance requirements are being met and raising significant issues to consider such as an entity's ability to continue as a going concern
- Performing analysis of the entity's environment to ensure ongoing compliance requirements are being satisfied
- Documenting the decision-making process that led to the filing of a loan application and the need for funds and tracking and documenting how PPP funds are spent
- Assessing and proposing enhancements to public company disclosure policies and controls particularly surrounding the impact of a PPP loan on an entity's operations and the circumstances that necessitated the loan in the first place to protect against the improper dissemination and use of material nonpublic information

Both borrowers and lenders should carefully evaluate their CARES Act legal and compliance risk strategies to develop an action plan that reduces operational and financial risks to the business.

