

Clients & Friends Memo

COVID-19 Update: The Paycheck Protection Program – Loan Participation Transactions

April 26, 2020

On Friday, April 24, 2020, the Small Business Administration (“SBA”) addressed some of the confusion regarding secondary market transactions involving Paycheck Protection Program (“PPP”) loans, at least with respect to participation transactions. In a Procedural Notice to SBA and PPP lenders, the SBA announced that it was lifting certain restrictions on participation transactions involving such PPP loans.¹

As explained in our prior Clients & Friends memos, “[COVID-19 Update: The SBA's Paycheck Protection Program Explained](#)” and “[COVID-19 Update: The Paycheck Protection Program and the Secondary Market](#),” PPP loans are a form of SBA Section 7(a) loan, a traditional form of SBA guaranteed loan. Confusion has existed since the inception of the Program due to the CARES Act’s statutory language and the nature of the PPP loans and how they are regulated. Section 1102(a) of the CARES Act provides that PPP loans “shall be eligible to be sold in the secondary market consistent with this subsection.” This statement regarding sales in the secondary market was echoed in Treasury Department releases describing the PPP. “This subsection” refers to Section 7(a) of the Small Business Act.² On April 17, the SBA and the Treasury Department issued an FAQ reaffirming that “A PPP loan may be sold into the secondary market at any time after the loan is fully disbursed” and that “A secondary market sale of a PPP loan does not require SBA approval.”³

Although not addressed in the CARES Act, the SBA’s existing regulations nonetheless impose some limitations on the ability of Section 7(a) loans to be transferred in the secondary market. With respect to participations, existing SBA Section 7(a) regulations require a prior notice for participation transactions up to 90%, and prior consent for participations above 90%.

¹ <https://content.sba.gov/sites/default/files/2020-04/Procedural%20Notice%20-%20PPP%20Loan%20Participations.pdf>

² 15 U.S.C. § 636.

³ Paycheck Protection Program Loans Asked Questions, FAQ #30 (Apr. 17, 2020), <https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequently-Asked-Questions.pdf>

Participations can be made only to other SBA lenders. The SBA historically has required a formal Multiparty Agreement for participations above 90%.⁴

Regarding the “notice” concept, it is important to note that the notice concept refers to the transaction, not to the participants. SBA regulations provide that SBA originating lenders may participate away their loans only if pre-approved to do so; the SBA has to first determine that the originating SBA lender is sufficiently sound before it may participate away its loans.⁵ Thus, although an SBA lender may enter into 90% (or less) participating transactions subject only to a notice requirement with respect to the transaction, the originating SBA 7(a) lender has to be a lender that has been approved by the SBA to enter into participations.

In the SBA’s Procedural Notice, the SBA announced that it is pre-approving all PPP originating lenders to participate away the PPP loans originated by that lender, effectively granting participation authority to all Section 7(a), Form 3506,⁶ and Form 3507⁷ PPP originating lenders. The SBA announced that it is maintaining the prior notice requirement, but that all PPP participations may go up to 100% – in effect, eliminating the prior consent requirement for participations above 90%. The SBA further made clear that servicing responsibilities must remain with the PPP originating lender, even in a 100% participation. This suggests that the entity responsible for submitting the PPP forgiveness and guarantee claims to the SBA will be the originating PPP lender.

Most notably, in the Procedural Notice, the SBA indicated that it is maintaining its requirement that the entity acquiring the participation interest must itself be an SBA-regulated entity – *i.e.*, either a Section 7(a) lender, or an entity that is authorized to originate PPP loans after having filed Form 3506 or Form 3507 with the SBA. This announcement by the SBA suggests that for other types of transactions – in particular, whole loan sales – the SBA will expect that the purchaser of the PPP loan also be an SBA-regulated entity (and possibly subject to existing SBA “secondary market” whole loan transfer protocols as well), frustrating some efforts by PPP lenders to sell whole PPP loans to non-SBA regulated entities.

The SBA’s Procedural Notice clears the way for PPP originating lenders to finance their originations by participating away the PPP loans to other SBA-regulated lenders, including most banks. This is

⁴ 13 C.F.R. § 120.432(b).

⁵ 13 C.F.R. § 120.433(b).

⁶ Form 3506 is the form submitted to the SBA by FDIC-insured depository institutions that do not currently have Section 7(a) loan authority. After submission of the notice, the depository institution is automatically permitted to begin originating PPP loans.

⁷ Form 3507 is the form submitted to the SBA by entities other than FDIC-insured depository institutions that do not currently have Section 7(a) loan authority. Such entities may begin originating PPP loans only after the SBA approves.

critical, given the additional \$310 billion in PPP funding approved last week and the resumption of the origination of PPP loans as soon as April 27th.

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