PRUDENT GENEROSITY: DUE DILIGENCE OF CARES ACT AND OTHER COVID-19 EMERGENCY LOANS

This week the White House and Congress agreed on a $484 billion funding deal to help small businesses, hospitals and Covid-19 testing. The spending package's passage infuses another $310 billion into the Paycheck Protection Program ("PPP"), $60 billion of which was set aside for regional banks, community-based lenders and credit unions with an added $10 billion to cover lenders' administrative costs. There's also $60 billion allocated in the legislation for the Economic Injury Disaster Loans Program, which covers grants for small businesses.

The administration of these Small Business Administration ("SBA") loan programs is being done by financial institutions including regional banks, community-based lenders and credit unions. The CARES Act provides delegated authority for them as lenders to make borrower eligibility and creditworthiness determinations. Traditionally the SBA would approve the loans but in Congress' haste to make sure capital gets into the hands of America's thirty million small businesses, it delegated due diligence responsibility for the loans to SBA approved lenders.

Restaurant owners, retailers and scores of other small business owners, a majority of which have ten employees or less, are now scrambling for this forgivable capital. The portion of the loan that covers eight weeks of expenses does not have to be paid back if at least 75% of the money is spent retaining or rehiring workers. Otherwise, it carries a 1% interest rate and must be paid back within two years. But since the administration of which small businesses qualify for PPP loans, and on the back end which ones should have their debt forgiven, falls on these same regional banks, community-based lenders and credit unions, it is important for them to know who the customer is. This is achieved by conducting some level of due diligence on each small business borrower whose loan application the institutions' review, approve and ultimately service.

This arrangement is fraught with risk for those financial institutions that participate in the PPP lending program. After Hurricane Katrina, the National Center for Disaster Fraud (NCDF) was established to combat all types of fraud relating to crises and their aftermath and is currently spearheading DOJ's Covid-19 fraud monitoring efforts. The NCDF, along with other oversight bodies including Congress, Government Accountability Office, Pandemic Response Accountability

Committee and Special Inspector General for Pandemic Recovery will all heavily scrutinize lenders participating in the CARES Act lending programs for violations of the False Claims Act and other regulatory requirements. The actions of these authorities can be expansive and may include the issuance of subpoenas and investigations of those in and outside the government, including corporate executives accepting federal aid under the CARES Act.

Due Diligence Investigations

Independent due diligence investigations allow regional banks, community-based lenders and credit unions alike to effectively and efficiently minimize risk, advance opportunities, ensure integrity, and make informed decisions. Such investigations typically involve reviews of open-source records and news and social media. If appropriate, investigations are supplemented with discreet human intelligence source interviews with government officials, industry representatives, personal and business associates, and other relevant parties.

Investigations focus on key indicators of transparency, integrity, and reputation, such as:

- Company history, including origins and past legal and beneficial ownership, types of business undertaken in the past, relevant experience, and degree of success;
- Present corporate structure, the nature and scale of the company's business, the location of any offices or facilities, and the number and location of employees;
- Accuracy and completeness of information supplied by the company;
- Integrity and business reputation of the company including propriety, allegations, scandal, investigations, audits, misconduct, criminal/regulatory charges/prosecutions, civil claims/litigation/judgments, and ability/willingness to fulfill commitments;
- Key relationships of the company, including with politicians, government officials, legal and beneficial shareholders, trading partners, and others exerting control or influence over the company; and
- Other relevant issues, such as including source of wealth, business practices, political donations/gifts/contributions, etc.

Appropriate Level of Diligence

As time is of the essence for businesses looking to shore up third party networks amid the coronavirus pandemic, due diligence investigations in this context should, at a minimum, review applicable public and proprietary databases to reveal, among other items, the company's:

- Identifiers and relevant background;
- Derogatory media references in English and appropriate local languages; and
- Inclusion on various sanction, embargo, regulatory, enforcement, debarment, and banned lists from around the world.

An investigation of this scope can typically be completed in a few days.

If the initial investigation raises a particular concern about a company, a more robust due diligence investigation is warranted. For instance, detailed reviews of open-source records using applicable public and proprietary databases and other sources, along with additional news and social media research, in English and appropriate local languages, could uncover significant relevant references.

Such detailed reviews attempt to identify, among other items, involvement in criminal and civil legal actions, liens, judgments, UCC filings, real, personal, and intellectual property records, and regulatory and other filings, depending on the jurisdiction involved. An investigation of this scope can typically be completed in a week or two.

Prudent Generosity

During this time of uncertainty for all businesses, a thorough approach to due diligence reviews could prevent a crisis from becoming worse, compounding the Covid-19 pandemic with increased financial, reputational, and other risk including Congressional, criminal or civil investigations or regulatory examinations and audits. Conducting appropriate due diligence before extending credit for emergency loans would be worth the investment in time and cost.

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Bradley Dizik advises publicly held, private and not-for-profit institutions on integrity issues, including development and evaluation of ethics and compliance programs and related best practices, institutional structure and culture, risk oversight, board and committee structure, board and executive leadership, independent and internal investigations, and audits and assessments. Mr. Dizik is currently advising the President and Board of Regents of the University of Michigan on the implementation of internal controls and structural and cultural transformation efforts in response to its sexual misconduct crisis. He is also a key member of the team investigating and assessing the Southern Baptist Convention's handling of sexual abuse allegations and related treatment of survivors and practice reform efforts.

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Christopher A. Arkin has extensive experience working with clients in connection with sensitive and high-stakes regulatory matters, internal investigations, and criminal and civil litigation. He has represented global companies, financial institutions, boards, executives, and directors involving a wide variety of substantive issues and areas of the law, including anti-bribery and corruption, securities and financial fraud, environmental and safety-related laws, and corporate governance. He has conducted investigations and other assessments in Latin America, Asia, Africa, and throughout the United States