



Borrowers Beware

Risks Related to the Federal Paycheck Protection Program (PPP)

July 16, 2020

Important Updates to the PPP Program

1. As of June 30, 2020, the PPP has **loaned \$521 billion**.
2. The **new deadline** for borrowers is **August 8, 2020**.
3. There is now a **24-week window** to use funds and still receive forgiveness.
4. Only **60%** of the loan must be spent on payroll.

Sources: U.S. Department of the Treasury, Small Business Administration.

In general, any business that receives money from the federal government has a heightened risk of audit, investigation and/or regulatory charges. These risks may be higher for companies that borrowed from the Federal Paycheck Protection Program (PPP), implemented on March 27, 2020, in response to the COVID-19 pandemic.

A component of the Coronavirus Aid, Relief and Economic Security Act (CARES Act), the PPP is a Small Business Administration (SBA) loan program designed to provide immediate financial support to small businesses to keep workers employed. The SBA will forgive loans if a borrower meets all employee retention criteria and uses the funds for eligible expenses.

The government is examining these loans to ensure legitimacy, appropriateness, and compliance. Their findings may leave some companies facing unanticipated audits and investigations. For this reason, many borrowers are trying to assess the risk to their executives and organizations while reviewing their current insurance programs for protection against PPP-related risks.

The IG, the DOJ and the SEC

The CARES Act established an independent inspector general (IG) who will conduct, supervise, and coordinate audits and investigations related to CARES Act loans. The inspector general is authorized to issue subpoenas and investigate borrowers. The Department of Justice (DOJ) has initiated action against certain individuals and more aggressive regulatory scrutiny is expected.¹

Further, the Securities & Exchange Commission (SEC) is actively investigating whether certain loan recipients have violated federal securities laws.

¹ <https://www.justice.gov/opa/pr/two-charged-rhode-island-stimulus-fraud>

Recipients Disclosed

In early July 2020, the U.S. Treasury Department disclosed the names of companies that have taken PPP loans larger than \$150,000. This disclosure raises concerns that PPP money is not flowing to the intended recipients (i.e., small businesses in need of immediate relief to survive). The names of public companies and private equity/venture capital organizations on the list of PPP recipients raised eyebrows and caught the media's attention. Not surprisingly, calls for more transparency within the program are getting louder.

Directors & Officers (D&O) Liability: Tips from USI's D&O Insurance Specialists

As the government continues to audit and investigate borrowers and their executives, D&O liability claims are likely to arise, causing distraction and potential financial loss.

USI has extensive experience evaluating D&O liability claims, including regulatory investigations and proceedings. Our professionals can help clients better understand their D&O liability insurance and determine whether their policies will offer any protection. Areas of focus include:

Individuals vs. the Company: When a government agency audits participation in a government program, begins an informal inquiry, or opens a formal investigation, will D&O liability insurance respond? In general, if the inquiry or investigation targets an individual director or officer, D&O coverage will be triggered, but it may not cover costs associated with the organization itself.

- USI suggests that all companies examine the definition of "Claim" within their D&O policy and verify that there is clear coverage for "pre-claim" inquiries. In addition, public companies should review the breadth of the definition of "Securities Claim", as this is typically the only type of claim for which the organization itself is covered.

False Claims Act (FCA): The FCA imposes liability for defrauding the government. With the PPP, there is a heightened risk of FCA actions, including those triggered by qui tam complaints. A qui tam complaint is made by a third party (a so-called "whistleblower"). Qui tam claims remain under seal for at least 60 days, which can make it difficult to establish precisely when the claim was first made.

- USI suggests that borrowers examine reporting requirements in their D&O policies. These policies are "claims (first)-made and reported" forms. It is critical for policyholders to understand the triggers that would obligate them to report a claim. Ideally, the policy will require that qui tam claims be reported only when they become unsealed and served.
- Further, borrowers should review any pending and prior litigation exclusion in their policy to ensure coverage is not removed for claims based upon or arising out of any pending or prior litigation/proceedings/events of which the insured is unaware.

Conduct Exclusions: Complaints brought against D&Os for alleged wrongdoing in taking PPP monies will likely allege deliberate criminal or fraudulent acts. Most D&O policies exclude claims arising from such acts. However, these so-called "conduct exclusions" are typically intended to apply only following an adverse final adjudication that establishes the fraud. In other words, coverage for defense, and any settlement prior to adjudication, should not be barred by these exclusions.

- USI suggests that borrowers review the “conduct exclusions” in their primary D&O policies, as well as any Side A-only D&O policies separately purchased (a Side A-only policy covers only losses not indemnified by the company). In addition, companies should examine their policies for suitable severability language as respects the exclusions so that the acts of one insured do not impute to another insured.

Definition of “Loss”: Are loan repayments or associated fines considered covered “losses” under a D&O policy? Generally, disgorgement of “ill-gotten” gains by an Insured is not covered as a matter of public policy. However, depending on the jurisdiction and specific policy language, some coverage may be available for defending the matter and subsequent judgments or settlements. Similarly, coverage for fines and penalties may depend on jurisdiction and policy language. For example, coverage may differ for criminal fines/penalties *versus* civil fines/penalties.

- USI suggests that borrowers carefully examine both the “Exclusions” section (including any exclusions added by endorsement) and any exclusionary language within the definition of “Loss”, or within other definitions, of their D&O policy.

Conclusion – D&O Coverage: As more information about the PPP program emerges, the likelihood of government inquiries, and subsequent claims, increases. A properly designed D&O liability policy offers a broad scope of coverage for a wide array of “claims”, even if only for defense costs.

- USI suggests that borrowers review their existing D&O coverage and remain attentive to any coverage restrictions proposed during the next renewal process. Doing so can mean the difference between meaningful risk transfer and unintended risk retention.

Contingent Liability Insurance: A Compelling Solution Beyond D&O

A small number of insurers in the transaction liability underwriting sector offer (or will consider) Contingent Liability insurance coverage to address certain losses arising in the PPP loan procurement process. These facilities focus primarily on losses arising from errors or inaccuracies in the following areas:

- Necessity Certification Process: The borrower must certify that current economic conditions make the loan a necessity to support the applicant’s ongoing operations and that other options were exhausted.
- Compliance with the PPP’s Maximum Employee requirement: The rule factors in an applicant’s affiliates (which may be problematical when, for example, the applicant is a private equity sponsor of portfolio companies). The SBA’s Affiliation guidance is complex and allows for exceptions and exemptions, but it is not yet clear how this guidance will be interpreted and enforced.

Contingent Liability coverage may be a compelling option given the limited clarity of the program’s rules and requirements. In the underwriting process of Contingent Liability coverage, applicants can expect:

- A deep and thorough review of the loan application process.
- Rigorous analysis of whether program requirements were met and followed.
- An examination of any outside guidance (from law firms, consultants, i.e.) received by the applicants.
- Requests for ample documentation in support of the foregoing.

How USI Can Help

As specialty coverage specialists, USI is uniquely positioned to help borrowers, or potential borrowers, mitigate PPP-related risks. To learn more about how USI can help, contact your USI representative, or visit our website at www.usi.com.

Helpful Resources

To help clients navigate these challenging times USI has implemented a **STEER (Steer Through Epidemic & Economic Recovery) Task Force**. This cross-functional team is working to provide timely COVID-19 information, understand cross-industry and geography impact and evolving responses, and to develop and deliver tailored solutions to help clients **steer** through this epidemic challenge and economic recovery.

For additional resources, tools, information, and links, please visit our COVID-19 resource page: www.usi.com/public-health-emergencies



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