FinReg Round-Up

NEWSLETTER

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We want to start this month's FinReg Round-Up by expressing our sincere hope that you are staying safe and healthy. These are without a doubt unprecedented and challenging times, and we are grateful that today's technology allows us to stay connected with our clients and colleagues.

Unsurprisingly, we are focusing this month's FinReg Round-Up on some items of note as Congress, regulators and the private sector act to address and adjust to the financial impacts of COVID-19. The Federal Reserve is implementing a number of programs that were useful during the 2008 financial crisis, including the Commercial Paper Funding Facility and the Money Market Mutual Fund Liquidity Facility. Federal and state bank regulatory agencies are encouraging financial institutions to work with customers experiencing financial hardship, and they have adjusted supervisory expectations and capital rules to give financial institutions more flexibility in handling delinquent loans.

We could not possibly summarize everything that has happened in the past month; instead, we will focus on a few items of interest:

Paycheck Protection Program

Implementation of the PPP has been extremely bumpy. The launch of the $349 billion loan program only a week after the CARES Act became law left financial institutions and small businesses scrambling. Treasury and the Small Business Administration (SBA) issued guidance and interim regulations piecemeal and updated them almost daily. The SBA's 100% guarantee of these loans and the potential for partial or full forgiveness made the PPP extremely attractive to both lenders and borrowers.

Because the PPP is a type of SBA Section 7(a) loan, a good deal of SBA policy and guidance was imported into the program. One of the largest hurdles is the SBA's affiliation rules, which require the headcounts of all "affiliated" companies to be aggregated. The Treasury and SBA have issued interim final rules, additional interpretations and FAQs on the applicability of the affiliation rules to

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the PPP loans; some narrowing of the definitions of affiliation offered a bit of relief. A number of venture capital- or private equity-backed companies that would ordinarily qualify for the PPP are finding that they are now disqualified, however.

Just as the PPP seemed to be moving a little more smoothly and applicants were receiving approvals, the funds appropriated to the PPP were exhausted. The speed at which the funds were used up was unexpected. Many potential borrowers have been locked out of the PPP, particularly sole proprietors and independent contractors who were not permitted to apply for PPP loans until the second week of the program. There has been pressure on Congress to appropriate additional funds for the PPP and to try to ensure that the loans go to these smaller businesses.

The Senate passed a bill April 21 that would add an additional $310 billion to the PPP, bringing the total to $659 billion. The bill also would require $30 billion of those funds to be allocated for PPP loans made by smaller banks and credit unions (those with total assets between $10 billion and $50 billion). Another $30 billion is to be allocated for PPP loans made by small banks and credit unions with total assets of no more than $10 billion, as well as community development financial institutions, minority depository institutions and other designated financial institutions that serve minority or underserved areas. The Senate bill is expected to pass the House on April 23. The PPP could reopen as early as April 24, just over a week after it ran out of initial funds.

Main Street Lending Program

The Federal Reserve created the MSLP, which is intended to provide low-cost loans to small and midsize businesses (up to 10,000 employees). Under the MSLP, a special-purpose vehicle set up by the Federal Reserve will purchase 95% participations in the loans, with the lender retaining 5%. So far, the Federal Reserve has issued term sheets for only the two categories of MSLP loans.

We are still waiting for additional substantive details on the program, although the initial response from lenders and borrowers has been lukewarm. Unlike PPP loans, the MSLP loans are not subject to forgiveness and they have a higher interest rate than do PPP loans. In addition, the minimum loan amount in the MSLP is $1 million, while according to information released by the SBA, the amount of the average loan in the PPP so far has been around $210,000, and around 95% of the PPP loans were for amounts of $1 million or less.

A number of industry stakeholders have submitted comments on the MSLP suggesting changes and clarifications, including lowering the minimum loan amount, using LIBOR instead of SOFR as the interest rate and allowing lenders more flexibility in setting the terms of the loans. We do not yet know how the comments are being received, but we expect the Federal Reserve will make some adjustments to the MSLP based on input it is receiving. Once the MSLP launches (reportedly in early May), we will have a better sense of its utility in the marketplace.

Contactless Payments Update

While it is unclear when the current COVID-19 health crisis will end, the government and businesses are beginning to discuss what our new normal will look like. The shutdown resulting from COVID-19 has profoundly affected how we interact and transact with each other. As consumers seek to avoid handling paper currency and plastic cards for fear of contamination, one shift in consumer behavior that likely will last beyond the end of this crisis is the increased use of contactless payments.

Merchants operating during this pandemic—from local restaurants to national retailers—are scrambling to respond to this new consumer demand. And as thousands of other merchants begin planning to reopen in the months ahead, they will have to reevaluate how to provide the type of customer experience that will coax shoppers back.

Contactless payments can be made using NFC-enabled credit cards or digital wallets (e.g., Apple Pay, Samsung Pay, Google Pay), the latter involving a smartphone or connected device. These transactions are more secure than traditional point-of-sale transactions. All NFC-enabled payments are powered by the same technology that powers EMV "chip" cards, which means that contactless payments are nearly impossible to counterfeit. To secure each transaction, contactless payments also

utilize tokenization, which protects consumer data by replacing sensitive payment data with a unique digital identifier, called a token. Each token is valid for only a single transaction and does not transmit any sensitive data. So even if fraudsters were to somehow access tokenized data, they would be unable to use it to identify the cardholder or card number.

Contactless payments made through a digital wallet in a smartphone or through a connected device provide an added level of protection against fraud and data compromise. Today's smartphones use multilayered and biometric authentication—typically a fingerprint, face scan or PIN—in order to perform a transaction. That means only the smartphone's owner can initiate a payment.

Contactless payments have been on the rise for several years across the globe. The U.S. has lagged behind, but that is quickly changing. The payment card networks are doing their part, increasing awareness of contactless methods of payment and raising transaction value limits in dozens of countries. Card issuers are stepping up the production and distribution of NFC-enabled cards. And restaurants, retailers and even health care providers are quickly adopting contactless payment capabilities.

In federal and state government discussions about what reopening the economy will look like, contactless technologies are certain to play a central role—for their ease of use, security, and health and safety benefits..

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