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Investment Management ADVISORY ■

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Relief Under the CARES Act for Fund Managers

In response to the coronavirus (COVID-19) pandemic, on March 27, 2020, President Trump signed into law the Coronavirus Aid, Relief, and Economic Security (CARES) Act. This is a $2 trillion stimulus package intended to provide financial relief to businesses affected by the coronavirus pandemic, including managers of hedge, private equity, real estate, and venture funds.

Fund managers may benefit from the CARES Act under the Paycheck Protection Program (PPP). Through the PPP, the Small Business Administration (SBA) has the authority to provide 100% federally backed loans through December 31, 2020 to help eligible fund managers pay operational costs such as payroll, rent, and utilities. If a fund manager satisfies certain conditions, portions (and in some cases all) of the loan are forgivable, making the loan a grant.

Borrowers must complete and submit a loan application with the required documentation to an approved lender[1] that can process their application by June 30, 2020. Borrowers are advised to apply as soon as possible because the SBA has indicated that PPP loans will be provided on a first-come, first-served basis, there is a funding cap, and it will take lenders time to process the high volume of applications that are expected. A copy of the application form for loans through the PPP is available here and must be submitted to the lender along with payroll documentation.[2]

Are Fund Managers Eligible?

As a general rule, fund managers with fewer than 500 employees, not including independent contractors, are eligible for the PPP relating to the covered period, between February 15, 2020 and June 30, 2020.[3] In addition, a fund manager had to be conducting operations on February 15, 2020 and have employees for whom the fund manager was paying salaries and payroll taxes.

1 Approved lenders are those that have previously been approved as SBA 7(a) lenders. There are a number of exceptions and qualifications, so it will be important to consult with your legal advisor.

2 Note that many lenders are only accepting PPP loan applications from their current members who have banking business with them. Your lender's PPP loan application may vary from the standard application issued by the SBA.

3 Alternatively, investment funds may use an "alternative size standard" and qualify for the PPP if the fund's maximum tangible net worth on March 27, 2020 is not more than $15 million and the fund's average net income after federal income taxes (excluding any carryover losses) for the two full fiscal years before the date of the application is not more than $5 million. Note that the affiliation rules still apply to this standard. Therefore, all affiliated businesses must be considered in calculating the $15 million net-worth limit and the $5 million average-net-income amount.

Fund managers of private equity or venture capital funds that own or otherwise maintain a control position in portfolio companies may be ineligible for participation under the SBA's affiliation rules, which require a fund manager to aggregate its own employees and all the employees of its affiliates for purposes of the 500-employee limit. As a result, many fund managers that might otherwise qualify on a standalone basis (or whose individual affiliates might qualify on a standalone basis) would be ineligible for participation if the aggregate number of employees among affiliates is over 500. Absent an exemption, the SBA considers entities to be affiliated when one entity controls or has the power to control the other, or when a third party controls or has the power to control both entities. Further, a fund manager's minority investments will constitute control, and hence trigger the affiliation rules, if the fund manager has the ability under a portfolio company's charters, bylaws, or shareholder's agreement to prevent a quorum or otherwise block action by the board of directors or shareholders. The CARES Act notably does exempt certain businesses from aggregation with other commonly controlled entities, including businesses in the "accommodation and food services" sector such as hotels, motels, and restaurants that meet certain qualifications. The SBA may release additional guidance further clarifying the impact of its affiliation rules on fund managers and their eligibility to participate in the PPP.

One thing to note is if a fund manager receives a PPP loan, it will not be eligible for the employee retention credit for certain employment taxes offered under the CARES Act. Fund managers that cannot qualify for a PPP loan should consider whether they may be eligible instead for the employee retention credit. The employee retention credit is a refundable tax credit for eligible employers of any size that, during a calendar quarter in 2020, either (1) fully or partially suspend operations due to a government order related to COVID-19; or (2) experience a "significant decline in gross receipts." The credit is equal to 50% of the qualified wages (up to $10,000 for each employee) paid to each employee after March 12, 2020 and before January 1, 2021, resulting in a maximum credit per employee of $5,000. Additional information on the employee retention credit is available here. Fund managers with more than 100 employees may only claim this credit for employees it pays but are not performing services for the fund. Fund managers with 100 or fewer employees can claim this credit for employees that they continue to pay, whether they are working or not. Importantly, the affiliation rules at play when considering PPP do not apply here.

How Much Can a Fund Manager Borrow Under the PPP?

Each eligible fund manager may borrow up to 2.5 times its average monthly payroll costs in the 12 months preceding the loan, with a maximum loan of $10 million.

Certain payroll costs are excluded in calculating the maximum loan amount, including individual employee compensation over $100,000 (for employees with annual compensation exceeding $100,000, the first $100,000 of such individual's compensation may be included in the payroll cost calculation); Social Security, Medicare, and payroll and income taxes; compensation for an employee with a principal place of residence outside the U.S.; and qualified sick leave or family leave wages for which a fund manager will receive a credit under the Families First Coronavirus Response Act.

How Can Fund Managers Use the Funds Available Through the PPP?

An eligible fund manager can use the funds obtained through the PPP generally for the following expenses, subject to certain limitations:

- Payroll costs, including costs such as retirement benefits.
- Costs related to the continuation of group health care benefits during periods of paid sick, medical, or family leave, and insurance premiums.
- Employee salaries up to an annual rate of pay of $100,000, including bonuses.

- Interest payments on any covered mortgage obligation, not including prepayments.
- Rent and utility payments.
- Interest payments on any other debt obligations that were incurred before February 15, 2020, subject to certain limitations.

Due to the expected high demand for loans under the PPP, the U.S. Treasury Department has stated that no more than 25% of the forgivable amount may be for used for non-payroll costs. This means that at least 75% of the forgivable amount must be used for the payroll costs of employees (with a cap of $100,000 per employee for those employees making more than $100,000).

What Portion of the Loan Can Be Forgiven?

Fund managers receiving PPP loans can receive loan forgiveness equal to their payroll costs, utilities, and rent and/or mortgage interest during the eight-week period following the first disbursement of the loan if the fund manager maintains at least the same number of full-time equivalent (FTE) employees during the eight-week period. The amount forgiven will not be included in a fund manager's taxable income. The amount of loan forgiveness may be reduced based on a fund manager's decline in headcount or wages. Declines in headcount or wages between February 15, 2020 and April 26, 2020 will not trigger a reduction in loan forgiveness if the fund manager reverses the decline and returns to pre-decline levels by June 30, 2020.

For additional information on loan features, consult the U.S. Treasury Department's PPP Information Sheet, available here.

What Certifications Are Necessary to Apply for a PPP Loan?

To participate in the PPP, a fund manager must make certain good-faith certifications that establish that the fund manager understands and meets the eligibility requirements. Of particular note, fund managers must certify that: (1) the uncertainty of current economic conditions makes the loan request necessary to support the ongoing operations of the fund manager; (2) the funds will be used to retain workers and maintain payroll or make mortgage interest payments, lease payments, and utility payments; and (3) the information provided in the application and all supporting documents and forms is true and accurate in all material respects, including the certification that the loan is necessary to support the ongoing operations. At the option of the lender, the certification that the loan is necessary may be required to be supported by financial documents relating to the operations of the fund manager.

Knowingly making a false statement to obtain the loan is punishable under the law by imprisonment of not more than five years and/or a fine of up to $250,000; by imprisonment of not more than two years and/or a fine of not more than $5,000; and, if submitted to a federally insured institution, by imprisonment of not more than 30 years and/or a fine of not more than $1 million.

A fund manager must also do an analysis of whether it needs to disclose to its investors that it has applied for, and received, a loan under the PPP. If a fund manager believes that the information is part of the full and fair disclosure that is necessary for an investor to make an informed decision to invest (or remain invested) with the fund manager, the PPP loan information should be disclosed to investors.

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