STAFF ANALYSIS

Lessons from PPP Fraud for Potential Expansion of the SBA 7(a) Program

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> Over the course of the pandemic, the Paycheck Protection Program (PPP) provided 11.8 million forgivable loans worth nearly $800 billion and helped small businesses weather the disruptions from Covid-19. However, the speed with which the program was rolled out resulted in billions of fraudulent loans. This staff analysis summarizes reports and research relating to various aspects of fraudulent PPP loans and highlights key lessons to be applied to plans to extend the SBA's 7(a) program to non-banks.

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PPP Background

The Paycheck Protection Program (PPP) was an unprecedented effort to mitigate impacts to small businesses from government-imposed restrictions that effectively shut down the economy during the Covid-19 pandemic. One of the more impressive aspects of the program was the speed with which the funds were initially disbursed to impacted businesses. It took just 13 days in April of 2020 for $349 billion to be requested, approved, and disbursed to small businesses. In 2021, the program distributed an additional $278 billion from February to May. In total, 11.8 million loans were processed worth almost $800 billion within a timespan of just over a year.

While the speed and size of the program made fraud an almost inevitable consequence, the program's design and the SBA's structure may have exacerbated the problem. The Government Accountability Office (GAO) report, "SBA Added Program Safeguards, but Additional Actions Are Needed," concluded that SBA's organizational structure and priorities during the pandemic contributed to conditions where extensive fraud could exist. Examples include the fact that applicants simply needed to self-certify information and the SBA did not have policies or methods to verify borrower information before funds were disbursed or forgiven. The report also noted that during the first wave of the program, the agency's emphasis on speed led to program integrity challenges.

Enter the Fintechs and Other Non-banks

In addition to SBA's urgency to disburse funds at the beginning of the pandemic, additional conditions contributed to fraud during the 2021 iteration of the program. During the restart of the program, there was a shift in emphasis towards disbursing loans to sole proprietors, independent contractors, and self-employed individuals. In addition, the lender fee structure gave lenders the incentive to process several smaller loans rather than a few larger loans. The change in emphasis likely led to the increased PPP lending to more minority-owned and disadvantaged small businesses that faced challenges securing loans during the initial phase of the program. However, this change may have significantly increased fraud in the program. Lured by increased processing fees for smaller loans, non-bank lenders that lacked traditional small business lending relationships processed a staggering number of PPP loans in 2021. The non-bank lenders relied on automated approvals and online leads to new PPP borrowers from loan processors that claimed to have validated borrower information. In fact, there were more PPP loans processed in2021 (6.7 million) than in 2020 (5.2 million). While the top 15 PPP lenders in 2020 were all banks, 7 of the top 15 lenders in 2021 were nonbanks.

were more than 3.4 times as likely as non-fintech borrowers to have a felony record. (The PPP prohibited individuals with a felony record from receiving a loan under the program.) Others estimate that fintech's share of PPP fraud could be even higher. A Bloomberg investigation of DOJ data estimated that fintech's share of fraudulent loans could be as high as 75 percent. While fintechs were able to process PPP applications quickly, the data show that these lenders lacked the controls to limit bad actors from using the fintech's automated approval system to abuse the program.

Since the completion of the PPP, government entities have conducted several investigations to uncover the extent of fraud in the program, and the statute of limitations for PPP fraud was extended to 10 years. To examine the extent of waste, fraud, and abuse in the program, the SBA Office of the Inspector General (OIG) published, "SBA's Handling of Potentially Fraudulent Paycheck Protection Program Loans." The report stated that, although the OIG has not conducted a document-by-document review of loan files, there was a high amount of fraud within the program, based on the large volume of complaints of fraud OIG received to its hotline. As of December 2021, SBA OIG's fraud hotline had received over 54,000 complaints related to PPP, compared to just 52 total complaints received out of roughly 51,000 loans in 2019 for the SBA's 7a Program.

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