Published on *The National Law Review* https://natlawreview.com

Screening Failures Caused PPP Fraud

Article By:

Kurt R. Erskine

Philip G. Feigen

Adrienne E. Frazior

Alexandra G. Brooks

Ellen H. Persons

On December 1, 2022, the House Select Subcommittee on the Coronavirus Crisis released a staff report describing the poor performance of the financial technology companies that took a prominent role in administering the Paycheck Protection Program (PPP). Previously, the SBA Inspector General reported unprecedented levels of fraud within the program, in part due to a lack of sufficient specific guidance for lenders to effectively identify, track, address, or resolve potentially fraudulent PPP loans. The Committee, charged with examining reports of fraud related to the coronavirus crisis, initiated an investigation to determine the role of financial technology (fintech) companies that made “massive profits” by directing small businesses to lenders providing loans under the federal program. The report found that the fintech companies failed to fulfill their responsibilities to prevent fraudulent activity and caused significant harm and the loss of large amounts of program funds.

The PPP program launched with the 2020 CARES Act in response to the COVID-19 crisis to provide unprecedented levels of emergency funding in the form of SBA-backed loans intended to help businesses keep their workforce employed. Originally, banks gravitated to larger loans and more established applicants because those applications were easy to process and resulted in higher fees per loan. The result was that loans were not getting to the smaller borrowers that were potentially the most at risk. In response, Congress changed program rules to expand eligibility and increase fees for smaller businesses by up to ten times. In this context, technology-driven companies claimed that technology and innovation would allow them to better process loans for established financial institutions. Fintech companies, which operate largely outside of the regulatory structure governing traditional financial institutions and with little to no oversight from lenders, were given a significant level of responsibility in administering PPP loans. Chairman James E. Clyburn released a statement with the report, alleging that these companies “refused to take adequate steps to detect and prevent fraud despite their clear responsibility to safeguard taxpayer funds . . . [and] accrued massive profits from program administration fees.”

Two of the fintech companies investigated by the committee, Blueacorn and Womply, were created during or after the start of the COVID-19 pandemic solely to act as a lender service provider for small businesses. Since these companies are not banks, they could not directly lend money to applicants and instead acted as a middleman directing applicants to lenders and taking a cut of the fees lenders made on each loan. However, according to the report, Blueacorn only had one employee who assisted with processing PPP loan applications and therefore almost exclusively relied on third-party contractors to process loan applications. The reviewers worked as loan underwriters but reported receiving poor training and being pressured to “push through” PPP loans according to the report, even if there were questions regarding the authenticity of the loan’s supporting documents. Similarly, the report accuses Womply of putting their systems together with “duct tape and gum” and creating a high likelihood of fraud within the loans referred by the company to lenders. Blueacorn and Womply partnered with the six most active PPP lenders, facilitating nearly one in every three PPP loans in 2021 according to the committee’s investigation. The Select Subcommittee also found that due to the effort of Blueacorn and Womply, loans under $50,000 increased to $5.8 million in 2021, up from $3.6 million in 2020 and the program’s average loan size dropped from over $100,000 to $41,560 in 2021.

The Committee also investigated established fintech firms that became involved in the PPP loan program, Kabbage and Bluevine, which also struggled to administer the loans and prevent fraud. Internal Kabbage documents allegedly revealed that the company missed clear signs of fraud in a number of PPP applications, such as loans provided to farms that were questionable on their face, including an orange grove in Minnesota and a cattle ranch based on a New Jersey sandbar. According to the report, Bluevine initially experienced similarly high rates of fraud, but through continuous oversight and partnership with traditional financial institutions successfully improved anti-fraud controls with new software and incorporating manual review, likely reducing fraud. However, even with improved controls, Bluevine and its banking partner allegedly failed to timely submit Suspicious Activity Reports according to the committee report, in violation of applicable banking regulations.

Overall, more than 70,000 potentially fraudulent loans totaling more than $4.6 billion have been identified. Chairman Clyburn referred the Select Subcommittee findings to the SBA, OIG, and Department of Justice, including evidence that some owners of financial technology companies whose companies accepted billions in administration fees may have also directly committed PPP fraud.

© Polsinelli PC, Polsinelli LLP in California

National Law Review, Volume XIII, Number 18

Source URL:https://natlawreview.com/article/screening-failures-caused-ppp-fraud