

PPP Lenders Beginning to Receive Scrutiny Alongside Borrowers

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It is no longer only borrowers who are facing potential Paycheck Protection Program (PPP) loan scrutiny, although, as promised, SBA has indeed begun sending inquiries to borrowers who are seeking forgiveness of loans greater than \$2 million. Increasingly, however, lenders also are attracting the attention of federal regulators and investigative agencies.

We have previously discussed [what borrowers need to know if they accepted coronavirus relief funds](#) and [the many ways CARES Act funding can provide critical sources of money for both small and large businesses](#). We also have described the [oversight bodies](#) created by the CARES Act to police the use of disbursed funds, some of which are discussed below.

The CARES Act called on lenders to act with unprecedented speed to implement critical portions of the largest economic relief package in American history. In exchange, the government provided lenders with key liability protections, but those protections were not unlimited, and it appears at least some of those limits may begin to be tested. Here are answers to some of the top questions that may be on lenders' minds during this uncertain time.

What do we know about regulator inquiries of lenders so far?

In the past week, [Reuters](#) reported that federal regulators including the Department of Justice (DOJ), the Pandemic Response Accountability Committee (PRAC) and the Small Business Administration (SBA) Inspector General, have begun investigating whether lenders broke PPP program rules or other lending regulations. A source told Reuters that lenders are "looking for signs that lenders did not follow procedures, such as failing to properly vet borrowers' payroll expense calculations; whether staff knowingly helped ineligible borrowers get loans; if lenders favored or discriminated against a borrower or group of borrowers; or had inconsistent lending processes or policies." Reuters also reported that the Federal Deposit Insurance Corporation (FDIC), the New York Department of Financial Services (NYDFS), DOJ's Civil Rights Division, and the Consumer Financial Protection Bureau (CFPB) all have expressed interest in assessing fair lending and anti-discrimination compliance in PPP lending practices.

On October 16, 2020, the House Select Subcommittee on the Coronavirus Crisis released a [report](#) finding that many large PPP lenders "failed to prioritize small businesses in underserved markets, including minority and women-owned businesses." As part of its investigation, which [began in June](#), the Select Subcommittee sent letters to several major investment banks and two banking industry associations. The report found that three of them processed PPP loans for larger commercial clients at more than twice the speed of smaller loans, contrary to what Congress intended for the program.

At least some targeted inquiries began while the PPP was still underway. On May 5, 2020, one large financial institution – whose participation in the PPP program initially was limited by the growth cap imposed by the Federal Reserve after the bank's fake-account scandal – disclosed in a securities filing that it had received "formal and informal inquiries from federal and state governmental agencies regarding its offering of PPP loans." On May 27, 2020, a regional bank based in Georgia, received a civil investigative demand from the DOJ pertaining to its PPP loan approvals and payment of agent fees.

What are the limits on lender protections?

Potential liability for PPP lenders has been limited in key ways. Most importantly, lenders were permitted to rely on borrowers' certifications and supporting documentation in order to determine loan eligibility, including certifications regarding the necessity of the loan request, affiliate entities, employee headcount, payroll costs, and that the signer of the application was an authorized representative of the applicant. Lenders also are not required to externally verify the documentation a borrower submits in support of loan forgiveness.

Lenders were required, however, to perform a good faith review of PPP applicants' payroll calculations and make an independent determination as to whether an applicant's employees' principal places of residence are in the United States. In addition, lenders were not relieved of their Know Your Customer and Bank Secrecy Act obligations and were required to comply with fair lending rules, which prohibit discrimination in lending.

Should lenders be worried if they receive document requests from regulators or oversight entities?

The overwhelming majority of inquiries that lenders receive from regulators still will target potentially fraudulent borrowers. In those instances, lenders risk losing the fees associated with loans for which borrowers are determined to be ineligible. Lenders could expose themselves to greater scrutiny, however, if they are unable to produce the documents and information they were required to collect from borrowers.

Lenders that do receive inquiries from state or federal regulators or from Congress that request documents or information probing their broader lending practices should take the outreach seriously. Lenders that have met their obligations should not expect to face liability where they relied in good faith on borrower representations that turned out to be fraudulent. In contrast, lenders that fell short of their obligations may face liability or reputational harm from these inquiries. Lenders that originated a significant number of ultimately fraudulent loans need to ensure these were not a result of employee complicity or failures of internal controls. Finally, particularly with the change in administrations, it is reasonable to expect regulators to scrutinize more closely any lending practices that may have disproportionately impacted minority and other underserved communities or that otherwise implicated fair lending rules.

What can lenders do now to limit their exposure?

Many lenders have already begun conducting post-lending reviews to make sure their compliance procedures were sound and that employees followed program rules. Those that have not should consider whether such a review may pay dividends in later inquiries. In addition, lenders should continue to preserve relevant documents pertaining to their PPP lending activity, including documentation of their own internal policies and practices for review and approval of PPP loan applications.

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