Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515–6315

MEMORANDUM

TO:	Members, Subcommittee on Oversight, Investigations, and Regulations
FROM:	Dean Phillips, Chairman
DATE:	March 16, 2022
RE:	Subcommittee Hybrid Hearing: "An Empirical Review of the Paycheck Protection Program"

The Committee on Small Business Subcommittee on Oversight, Investigations, and Regulations will meet for a hybrid hearing titled, "An Empirical Review of the Paycheck Protection Program." The hearing is scheduled to begin at **10:00 A.M. on Wednesday, March 16, 2022 in person in Room 2360 of the Rayburn House Office Building, and virtually via the Zoom platform.**

To help small businesses retain employees and sustain operations during the early stages of the COVID-19 pandemic, Congress created the Paycheck Protection Program (PPP), a new forgivable loan guarantee program within the U.S. Small Business Administration (SBA) that delivered almost $800 billion in capital to small businesses. In the two years since the creation of the PPP, many researchers have reviewed and analyzed the loan data to assess the program's effectiveness in preserving jobs and reaching underserved small business owners. Though the program is still in the forgiveness phase, much of the empirical research shows the program effectively helped save millions of jobs but failed to reach the smallest of small businesses early enough to be maximally effective. This hearing will allow Members to hear from government and academic researchers about their findings on the effectiveness of the PPP and lessons learned about the distribution of loan funds. The witnesses will be:

Panel 1

- Mr. William Shear, Director, Financial Markets and Community Investment, U.S. Government Accountability Office, Washington, DC

Panel 2

- Dr. Robert Fairlie, Professor of Economics, University of California-Santa Cruz, Santa Cruz, CA
- Dr. Manju Puri, J.B. Fuqua Professor of Finance, Duke University Fuqua School of Business, Durham, NC
- Dr. Iryna Demko, Research Associate, Center for Economic Development, Maxine Goodman Levin College of Urban Affairs, Cleveland State University, Cleveland, OH
- Mr. Robert Barnes, President and Chief Executive Officer, PriorityOne Bank, North Magee, MS

Paycheck Protection Program

The PPP was established in the CARES Act[1] as a subprogram of SBA's 7(a) loan guarantee program. Under PPP, banks and other private lenders make fully guaranteed SBA loans to small businesses negatively impacted by the COVID-19 pandemic. The loans are intended to assist small businesses with meeting payroll costs and other expenses, and full loan forgiveness is offered if loan proceeds are spent on such purposes. In total, over $800 billion has been appropriated for PPP in several pieces of legislation.

The PPP and Health Care Enhancement Act[2] (Enhancement Act) included set-asides of newly appropriated PPP funds so that community lending institutions, including Community Development Financial Institutions (CDFIs), Certified Development Companies (CDCs) and SBA Microloan Intermediaries could participate in the program fairly alongside large banks. These set-asides were intended to maximize PPP lending in traditionally underserved business communities.

On April 12, 2020, SBA released the nonbank lender application form allowing new nonbank lenders to participate in PPP.[3] On April 30, 2020, SBA published an Interim Final Rule adjusting portfolio requirements for CDFIs, MDIs, and other nonbank lenders, which allowed smaller lenders to participate in PPP.[4] These nonbank lenders included SBA Small Business Lending Companies (SBLCs) and Non-Federally Regulated Lenders (NFRLs). As set forth in the following section, PPP research has shown nonbanks, CDFIs, and MDIs made a higher proportion of loans to traditionally underserved businesses than other types of lenders.

However, research also shows there is a higher degree of potential fraud associated with nonbank-originated (specifically Fintech-originated) PPP loans.[5] Some Fintech companies have sought to become an SBA 7(a) lender through SBA's SBLC license, however SBA placed a moratorium on approving new SBLCs in 1982. SBA did so to reduce the administrative resources needed to prudently regulate and oversee non-depository lenders with a nationwide 7(a) lending platform. Importantly, in a final rule posted December 4, 2020 on SBLCs and NFRLs, SBA stated it "does not have the administrative resources needed to oversee NFRLs with a nationwide 7(a) lending platform in addition to the 14 SBLCs it currently regulates."[6] In this final rule, SBA signaled it did not intend to re-open the SBLC license for existing or prospective NFRLs interested in making 7(a) loans nationwide by saying it "encourages [these lenders] to acquire one of the fourteen SBLC licenses that become available from time to time."[7]

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[1] P.L. 116-136.
[2] P.L. 116-139.
[3] U.S. Small Bus. Admin., *CARES Act Section 1102 Lender Agreement – Non-Bank and Non-Insured Depository Institution Lenders*, SBA Form 3507 (04/21), https://home.treasury.gov/system/files/136/SBA-Form-3507-PPP--Agreement-for-New-Lenders-Non-Bank-Non-Insured-Depository-Institution-Lenders.pdf.
[4] U.S. Small Bus. Admin., *Interim Final Rule on Corporate Groups and Non-Bank and Non-Insured Depository Institution Lenders (originally posted 4/30/2020)*, (Apr. 30, 2020), https://home.treasury.gov/system/files/136/IFR--Corporate-Groups-and-Non-Bank-and-Non-Insured-Depository-Institution-Lenders.pdf.
[5] *See*, Griffin, John M. and Kruger, Samuel and Mahajan, Prateek, *Did FinTech Lenders Facilitate PPP Fraud?*, (Dec. 6, 2021), https://ssrn.com/abstract=3906395.
[6] U.S. Small Bus. Admin., *SBA Supervised Lenders Application Process*, (Dec. 4, 2020) https://downloads.regulations.gov/SBA-2020-0001-0021/content.pdf.
[7] *Id*.

The PPP Flexibility Act[8] (Flexibility Act) established a minimum maturity of five years on PPP loans and extended the covered period during which borrowers may use such funds for certain expenses while remaining eligible for forgiveness from eight to 24 weeks. The Flexibility Act also raised the non-payroll portion of a forgivable covered loan amount from the current 25 percent up to 40 percent. S. 4116[9] extended the PPP application deadline to August 8, 2020, allowing more time for small businesses considering applying for a PPP to weigh their options.

The Economic Aid Act[10] made numerous improvements to PPP, including allowing borrowers who've spent all of their PPP loan to apply for a "Second Draw" PPP loan, and expanded the use of loan proceeds eligible for forgiveness. The American Rescue Plan Act[11] added $7.25 billion for expanded eligibility of small nonprofits and internet publishing organizations for PPP. Finally, the PPP Extension Act of 2021 extended the PPP loan application deadline to May 31, 2021.[12]

On June 1, 2021, the SBA stopped accepting applications for First and Second Draw loans. According to SBA's public data, as of May 31, 2021, the PPP guaranteed over 11.8 million loans through 5,467 lenders for a total net PPP dollars lent at over $799.8 billion, with an average loan size of approximately $67,647.[13] In 2021, over 6.6 million PPP loans were approved through 5,242 lenders totaling over $277.7 billion total net PPP dollars lent, with an average loan size of approximately $41,560.[14]

As of March 6, 2022, SBA made over 9.7 million full for partial forgiveness payments, representing 85 percent of all PPP loans.[15] These payments total over $701.7 billion in PPP lending, representing 89 percent of total PPP volume.

Research Overview

In the approximately two years since the creation of the PPP, numerous researchers within both government and academia have reviewed PPP loan data to evaluate the effectiveness and reach of program. Some of these researchers, including the witnesses on today's panel, focused specifically on the program changes implemented after the initial round of funding was exhausted, including funding set-asides for small and community-based lenders and the exclusive application window for businesses with fewer than 20 employees.

Government Accountability Office (GAO)

The CARES Act included a provision for GAO to monitor federal efforts to respond to the COVID-19 pandemic. GAO issued a series of reports on PPP and made numerous recommendations to

[8] P.L. 116-142.
[9] P.L. 116-147.
[10] P.L. 116-260.
[11] P.L. 117-2.
[12] P.L. 117-6.
[13] U.S. Small Bus. Admin., *Paycheck Protection Program (PPP) Report: Approvals through 05/31/2021*, (May 31, 2021), https://www.sba.gov/sites/default/files/2021-06/PPP_*Report*_Public_210531-508.pdf.
[14] *Id*.
[15] U.S. Small Bus. Admin., *Forgiveness Platform Lender Submission Metrics – March 06*, (Mar. 6, 2022), https://www.sba.gov/sites/default/files/2022-03/2022.03.07_Weekly%20Forgiveness%20Report_Public-508.pdf.

improve program performance and integrity. As part of the present report on PPP,[16] GAO analyzed loan-level PPP data from SBA and county-level data from four U.S. Census Bureau products and surveyed a generalizable sample of PPP lenders, stratified by lender type and size.

GAO found early PPP lending favored larger and rural businesses. Specifically, 42 percent of Phase 1 loans (those approved April 3-16, 2020) went to larger businesses (defined in the report as those with between 10 and 499 employees), although such businesses only accounted for 4 percent of all U.S. small businesses. Similarly, firms in rural areas received 19 percent of Phase 1 loans but represented 13 percent of all small businesses. GAO also found banks collectively made more than 93 percent of all Phase 1 loans.

In response to concerns that some small businesses, especially those owned by self-employed individuals, women, minorities, and veterans, faced challenges in obtaining loans, Congress and SBA made a series of changes to increase lending to these businesses. The PPP and Health Care Enhancement Act established a $10 billion set-aside for firms that applied for PPP through CDFIs to target funding to minority-owned businesses. The set-aside was established during what GAO refers to as Phase 2 of PPP, which ran from April 27 – August 8, 2020. Furthermore, SBA dedicated the first few days of Phase 3 (January 11 – May 31, 2021) to processing loans made through community lending institutions and established a 14-day loan application period exclusively for businesses or nonprofits with fewer than 20 employees. GAO found by the time PPP closed in June 2021, lending in traditionally underserved counties was proportional to their representation in the overall small business community. While lending to businesses with fewer than 10 employees remained disproportionately low, it increased significantly over the course of the program.

Dr. Robert Fairlie, Professor of Economics, University of California-Santa Cruz

Dr. Fairlie and his co-author's research provided the first analysis of how PPP funds were disbursed to minority communities during the third (and final) round of the program, which was targeted to such communities.[17] Using administrative microdata on PPP loans, they found a strong positive relationship between PPP flows (as measured by the number of loans per employer business or loan amounts per employee) and the minority share of the population or businesses in the third round. In contrast, the relationship was negative in the first round of 2020 and less positive in the second round of 2020. They also found a stronger connection between minority share and loan numbers or amounts to employer businesses for first draw loans than for second draw loans in 2021, capturing some persisting inequities as to the firms eligible for second draw loans (namely, those who accessed the program in 2020).

The patterns they found are similar for loan numbers and amounts to non-employer businesses but with a similarly strong connection with minority share for both first draw and second draw loans. Dr. Fairlie and his co-author specifically mention "[t]here is a clear evolution of PPP funding to

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[16] U.S. Gov't Accountability Off., *Paycheck Protection Program: Program Changes Increased Lending to the Smallest Businesses and in Underserved Locations*, (Sep. 2021), GAO-21-601, https://www.gao.gov/assets/gao-21-601.pdf.

[17] Fairlie, Robert W. and Fossen, Frank M., *The 2021 Paycheck Protection Program Reboot: Loan Disbursement to Employer and Nonemployer Businesses in Minority Communities*, (Feb. 2022), NBER Working Paper No. w29732, https://ssrn.com/abstract=4034182.

minority communities across subsequent rounds of the PPP from a negative relationship in the first round to the strong positive relationship in the rebooted program in 2021." Ultimately, Dr. Fairlie and his co-author found the "rebooted" PPP that ran from January to May 2021 appears to have been disbursed to minority communities as intended. They attribute this development to the empowerment of CDFIs in later rounds, as well as the 14-day application exclusivity period for microbusinesses.

<u>Dr. Manju Puri, J.B. Fuqua Professor of Finance, Duke University Fuqua School of Business</u>

Dr. Puri and her co-authors studied the use of banks to deliver of PPP funds, focusing specifically on the difference between big and small banks.[18] They reported that banks were overwhelmed in the initial stages of the PPP (due to both the aggregate shortage of PPP funds and the surge in applications for PPP), which they wrote provided a rare and clear window into banks' allocation priorities when facing resource constraints. They found significant differences in how big and small banks prioritize small clients: big banks are more likely to prioritize larger clients early. These findings suggest there are intermediary supply effects that impact the supply of PPP financing. They also show this effect is attenuated and even reversed for small banks, who extend more even treatment to their smaller clients.

Overall, they found prior lending relationships helped firms gain early PPP access. They also found little evidence that relationships with big banks helped more – if anything, small bank relationships helped firms get early PPP access, especially with small bank lenders. This finding about the importance of having a small bank relationship, and more broadly that lending relationships matter, supports the idea that the PPP and Health Care Enhancement Act set-asides for small and community-based lenders should've been part of PPP from the outset, since these lenders are likelier to have or establish relationships with businesses in underserved communities. Their research also finds a "funding hesitancy" by some firms to take PPP funds, most sharply evidenced by the 100+ publicly traded companies that received PPP funds and returned the funds without using them.

<u>Dr. Iryna Demko, Research Associate, Center for Economic Development, Maxine Goodman Levin College of Urban Affairs, Cleveland State University</u>

Dr. Demko and her co-author studied and analyzed access to PPP by woman- and minority-owned businesses.[19] Unlike the research groups led by Drs. Fairlie and Puri, Dr. Demko and her co-author conducted both a macro-level analysis of PPP loan data for rounds 1 and 2, and a micro-level analysis, which consisted of 19 structural interviews with a variety of small businesses in Northeast Ohio. The quantitative results show that a minority-owned business with 5 to 9 employees received a PPP loan that is 21 percent smaller than that received by their white-owned business counterpart. They also found a woman-owned business with 5 to 9 employees received a PPP loan that is 15 percent smaller than a male-owned business. Furthermore, they reported that woman-owned firms in rural counties received PPP loans that were between $2,634 and $8,856 smaller than those received by women-owned firms in non-rural counties.

[18] Puri, Manju, et al., *Small Bank Financing and Funding Hesitancy in a Crisis: Evidence from the Paycheck Protection Program*, (Sep. 7, 2021), https://ssrn.com/abstract=3717259.

[19] Demko, Iryna and Sant' Anna, Ana Claudia, *Impact of Race and Gender on the SBA Paycheck Protection Program (PPP) Loan Amounts*, (Jun. 10, 2021), https://ssrn.com/abstract=3864218.

The qualitative results from their interviews showed businesses that received smaller loan amounts had more difficulty with the loan application process, filed a larger number of applications, and pursued more alternative funding sources compared to businesses that received larger loans. Their interviews included 10 borrowers that received PPP loans of $150,000 or less, and nine that received loans greater than $150,000. Beyond reporting difficulty finding a lender, the smaller borrowers reported frustration regarding the information requested by each lender, which was not standard across lenders. Specifically, a lack of clarity over eligible expenses caused borrowers to forgo the opportunity to seek higher loan amounts. These borrowers also expressed frustration over the regular release of new guidelines and clarifications, which added many manhours gathering information and made the program challenging to "stay on top of."

On the other hand, none of the nine businesses interviewed that received loans greater than $150,000 reported pursuing funding through alternative sources. They found the smallest businesses had the least awareness of government assistance programs, including PPP, relative to larger firms, suggesting they would've benefitted from technical assistance with the program application, as they also tend to have fewer resources to pay consultant fees. The smaller borrowers they interviewed also recounted submitting multiple applications with multiple lenders, with many of them ultimately having more success with smaller, local banks rather than larger multistate banks. Finally, valuable feedback directly from program participants repeatedly mentioned the need for a centralized application portal. As the researchers found, different lenders had different applications that asked for different information, adding confusion and complexity to the process when businesses had to approach several different lenders and fill out new applications with new information each time.

Conclusion

The PPP represented a nationwide stress test of the small business economy and of the ability of small firms to access relief capital from a banking system that was similarly stress-tested in the first weeks of the program. In the almost two years since the program's creation, study after study has confirmed what entrepreneurs reported contemporaneously: that the smallest of them struggled to access program funds through the big banks. Following a series of program changes enacted by Congress and implemented by SBA, the program evolved in a way that made it more accessible for the smallest businesses. The findings presented during today's hearing show the program changes made midway through effectively steered program funds towards underserved and smaller businesses. These findings also inform how SBA's non-pandemic business loan programs can be improved to help them better reach more underserved entrepreneurs.