

BANK POLICY INSTITUTE

With FinTechs, Money Moves Fast. So Does Fraud

BPI Staff | September 1, 2021

When the Paycheck Protection Program (PPP) commenced, FinTechs were typically boastful about the speed with which they were processing loans, heaping scorn on banks who were more deliberate. The obligatory stories about the innovation and creativity of non-banks were produced. However, as we and numerous others predicted and rigorous, after-action reports are now showing, that innovation actually took the form of relaxed due diligence and a high tolerance for fraud, at a massive cost to taxpayers who foot the bill. The question now is whether nonbanks—which operate free of the types of the federal examination and enforcement visited even on small banks a fraction of their size—will ever be held to account through the supervision that gives consumers and policymakers confidence in banks. Is anyone minding this store?

June 2021...

The New York Times

How Two Start-Ups Reaped Billions in Fees on Small Business Relief Loans

Blueacorn and Womply processed one-third of all Paycheck Protection Program loans this year, stepping in when big lenders wouldn't.

August 2021...

The New York Times

15% of Paycheck Protection Program Loans Could Be Fraudulent, Study Shows

Some $76 billion of the program's $800 billion in loans may have been taken improperly, a new paper concludes.

In particular, the study cites two lenders, Capital Plus and Prestamos CDFI, as having fraud flags on roughly half their loans. Both of those lenders made nearly all of their loans through Blueacorn, a loan facilitator that drew in borrowers through a marketing blitz and steered them to its partners. Two other large online lenders, Cross River Bank and Harvest Small Business Finance, also had exceptionally high rates of suspicious loans, the researchers said.

It's inevitable that an unprecedented program like the PPP, meant to get money into the hands of lockdown-battered small businesses and their employees as quickly as possible, would suffer from some amount of fraud. But this fraud was disproportionately concentrated among FinTech lenders, which were almost five times more likely than traditional lenders to be involved with potentially fraudulent PPP loans. Of the top 10 lenders with the highest rates of suspect loans, nine were FinTech firms, according to a study released in August by the University of Texas at Austin's McCombs School of Business and cited by Bloomberg. Broadening the scope even further to the top twenty lenders demonstrates that 19 of those 20 are nonbanks, with the 20th being a community bank.

This FinTech fraud could add up to $76 billion in questionable PPP loans, the study said. And those misappropriated dollars have real economic consequences for Americans. Each illegitimate dollar of PPP money effectively robs actual small businesses and their employees of much-needed support.

In contrast, banks engaged in Bank Secrecy Act/Anti-Money Laundering (AML/BSA) and other due diligence obligations—in some cases beyond what the program required—before making PPP lending decisions and thus did not approve suspicious PPP loans to as concerning of a degree as FinTech lenders, which are not subject to the same BSA/AML requirements. Nor do these FinTechs have banks' extensive experience in conducting due diligence in connection with reviewing loan applications. And, while FinTechs did prove to be adept at providing PPP loans to minority borrowers, BPI research has shown that the largest retail banking institutions were instrumental during 2020 in providing PPP loans to smaller-sized businesses and to firms located in predominantly minority neighborhoods.[1]

And consumer harm wrought by FinTechs goes beyond the pandemic. Sometimes, it's as simple as not giving customers their money back when they ask for it. Chime, a FinTech app that advertises itself as "banking that has your back," recently came under scrutiny for closing customer accounts, sometimes without returning the funds. That's in addition to the trouble Chime got in for calling itself a bank when it's not—an incident that captures the essence of the problem—financial-services businesses that claim to be just like or even better than banks, but without being subject to the expansive regulatory and supervisory framework that ensures banks' safety and soundness.

In short, FinTechs' promises of nimbleness should be a warning sign, not a marketing draw. The areas where they save on costs—such as anti-money laundering safeguards, robust cybersecurity infrastructure and fraud detection procedures—enable fraud.

Policymakers must ensure that FinTechs implement appropriate risk management frameworks on a variety of fronts. Indeed, FinTechs offering banking services should be subject to the same supervisory and regulatory standards—from the full suite of AML rules to prudential regulation and data security and privacy standards—as banks.

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[1] As we noted, 30 percent of the loans originated by the nine largest retail banks were to areas with greater than 50 percent minority population, compared to 23 percent of the loans of smaller banks and nonbank PPP participating institutions. About 28 percent of loans originated by all banks larger than $50 billion in assets went to majority-minority neighborhoods. To place our discussion in the appropriate, broader context, it is important to note that the original PPP during 2020 had prioritized the preservation of small business jobs, through incentivizing the retention and rehiring of employees. Previous BPI research showed that PPP dollars per employee tended to be higher in areas experiencing more severe economic disruption due to the pandemic, consistent with program objectives. Also, more PPP dollars per employee were distributed to neighborhoods with a relatively high minority population share. These lending patterns were particularly evident among large banks.