PPP Insider Loans Extended – Pros, Cons & Pitfalls

lending board of directors PPP

Summary: Federal officials just extended a PPP rule change to March 31, 2022, which makes it easier for executive officers, directors, and principal shareholders to apply for PPP loans. These insider loans can be helpful for communities. We explain how, give you the pros and cons of providing insider PPP loans, and explain the potential pitfalls of reputational risk, special treatment, and difficulty denying loans.

Experts say that it takes about 10-20 minutes for most people to fall asleep. If it takes longer, you may have kept your body too alert through caffeine or recent exercise. If you fall asleep too fast, you could be sleep-deprived. In fact, 70% of Americans state that they don't get enough sleep at least one night per month, while 11% say that is the case every night. If you find yourself nodding off reading a book after dinner or while lying in the sun, you may be a part of one of these groups.

Regulators are definitely not nodding off, as they recently extended a rule change that makes it easier for executive officers, directors, and principal shareholders to obtain financing (via the PPP program) through the financial institutions (FIs) they represent. The rule extension to March 31, 2022, has particular importance for community financial institutions (CFIs) whose board members and principal shareholders are often small business owners and leaders in their communities.

How insider loans can be helpful

When the SBA first began offering PPP loans, officers and directors were excluded from getting PPP loans through their affiliated institutions. But, it was difficult for them to get these loans at other FIs, where they did not have a lender relationship. It quickly became apparent that PPP applicants who already had strong relationships with their lenders were often able to get the funds they needed, while PPP applicants who did not have this relationship often had a harder time getting a PPP loan. Sometimes, lenders were not able to accept new customers at all. If the goal of the PPP program was to help local, small businesses (who were healthy pre-pandemic) and stimulate the economy, the restriction was seen as running counter to the goal for this group of applicants. The exemption to the insider rule responds to that issue by opening the program enough to allow executive officers, directors, and principal shareholders in, provided they meet certain limits on equity ownership.

Pros and cons of insider loans

The relaxed rule could help both CFIs and some of the valued small businesses in their communities. It could also help bolster loan portfolios by allowing PPP loans to strong businesses that may have struggled during the pandemic. It also helps other businesses that were previously unable to access PPP loans from the institution where the business owner sat on the board or was a principal shareholder.
It all sounds like a win-win. But insider lending is an inherently risky endeavor. The relaxed rule doesn't necessarily mean CFIs are off the hook if the insider loan shows even a hint of favoritism. Institutions that choose to make these types of loans will need to pay very close attention to the details to ensure that they do not encounter unexpected regulatory and reputational risks.

The potential pitfalls

Navigating the legal issues can be tricky. Indeed, one law firm is advising bank clients to avoid making these insider loans despite the relaxed rules because of uncertainty about government loan guarantees.
What are some of the issues that CFIs should keep in mind?

1. **Reputational risk.** Insider loans could lead to issues of unfairness. Even if the loan is proper, it could be perceived otherwise and could tarnish its status in the community. Full transparency is important to help assure community members.
2. **Special treatment.** The relaxed rules still bar financial institutions from offering special treatment to insider PPP loans, including granting of the loan, speed of processing, or loan terms. It can be difficult for lending officials to treat a board member exactly as it would an outside business. Yet, it is important to follow the same exact guidelines since any lapse can subject the institution to costly sanctions.
3. **Difficulty in denying loans.** It may be more difficult for a CFI to deny a PPP loan to an insider, even if the underlying conditions would merit a rejection for a small business applicant from outside the institution. A bad loan hurts both the CFI and the business so think carefully before going down this path.

In short, CFIs that decide to go the insider route need to have clear and consistent policies on insider loans, and rigorous review of any insider applications.

Insider PPP loans can be good business, especially for qualified borrowers who show the ability to weather this storm with a little bit of help. It is important that CFIs treat these loan requests with utmost integrity so that this does prove to be a win-win for all.

LOAN GROWTH AND FLOATING RATE ASSETS

ECONOMY & RATES

Rates As Of: 07/07/2021 06:21AM (GMT-0700)

Treasury	Yields	MTD Chg	YTD Chg
3M	0.05	0.00	-0.04
6M	0.06	0.00	-0.03
1Y	0.07	-0.01	-0.04
2Y	0.23	-0.02	0.10
5Y	0.80	-0.09	0.44
10Y	1.33	-0.14	0.41
30Y	1.95	-0.14	0.31

FF Market	FF Disc	IORB
0.10	0.25	0.15
SOFR	**Prime**	**OBFR**
0.05	3.25	0.08